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Tax Glimpses 2016

We bring you a concise analysis of important judgements and noteworthy regulatory developments in corporate and financial services tax, global mobility, M & A tax,transfer pricing, indirect taxes and regulatory developments during 2016.

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Foreword

I am delighted to present our annual compilation, Tax Glimpses 2016.

The year 2016 was witness to major global political developments around the world – Brexit, the Italian referendum, and the US President elections, to name a few. In India, the demonetisation of high denomination currency has partially, but hopefully only temporarily, curbed otherwise positive sentiments.

On the tax front, the two T's - Transparency and Technology – have emerged as major potential disruptors. The OECD BEPS project is expected to bring about a paradigm shift in the way bilateral treaties can be modified, and could result in the use of tax treaties being severely curtailed. India saw its share of treaty amendments, including the treaty with Mauritius which, based on official statistics, at one time contributed to around 40% of the Foreign Direct Investment into India. Introduction of the equalisation levy on payments to non-resident providers of online/ digital advertising, and of Country-by-Country Reporting norms are examples of the BEPS impact in India, with a more recent one being the widening of the service tax ambit of online information and database access or retrieval. The publishing of confidential documents (the Panama Papers) further accentuated the importance of the transparency theme.

On the home front, FDI norms were further liberalised across various sectors, and on tax, traction was witnessed on resolving certain contentious issues by issue of clarificatory circulars and a heightened activity on the APA front. The passing of the GST Constitutional amendment paved the way for transformation of the indirect tax regime in India. Additionally, the focus and endeavour of the Government to weed out the parallel economy translated in the form of various declaration of income schemes and topped it with the demonetisation initiative. The much-expected guidelines for GAAR did not materialise during this year.

This compilation, *Tax Glimpses 2016*, captures some key Indian tax developments between 01 December 2015 and 30 November 2016, in the fields of corporate tax, personal tax, mergers and acquisitions, transfer pricing and indirect tax. This compilation also includes a listing (with web links, where available) of various PwC Thought Leadership publications released during this period.

I trust you will find this compilation useful, and look forward to your suggestions.

Wishing you the very best in 2017.

Gautam Mehra

Leader, Tax and Regulatory Services

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Corporate Tax

Case law

Permanent establishment

Income received by US Telecom Equipment supplier not taxable in India as no part of such income attributable to operations carried out in India

Nortel Networks India International Inc. *v.* DIT [ITA No. 666/ 2014 (Delhi)]

No part of the consideration received from supply of equipment was taxable in India as the title in the equipment was transferred outside India, and no operations were carried on in India. Further, on finding little or no evidence on record, it was held that the fellow subsidiary of the taxpayer did not constitute a business connection under the Act, nor the taxpayer's PE under the tax treaty.

Facts

The taxpayer was part of a Group, which was a leading supplier of telecom equipment to various telecom operators worldwide. The taxpayer was a wholly owned subsidiary of the Canadian company, which also had a LO and an indirect subsidiary in India (Indian company). The Indian company negotiated and entered into three contracts with an Indian telecom operator (Indian Telco) for equipment, services and software. On the same date, it assigned the equipment contract to the taxpayer, which was incorporated a day before the date of the contracts. The Indian Telco and the Canadian company were also parties to the assignment contract, wherein the Canadian company guaranteed the performance of contract by the taxpayer (assignee), and the Indian Telco agreed to place purchase orders and make payments directly to the taxpayer. The equipment supplied by the taxpayer was manufactured by the Canadian company and an Irish group company, and shipped directly to the Indian Telco in India.

Decision of the lower appellate authorities

The CIT (A), on the footing that (a) taxpayer was incorporated just before the date of assignment contract; (b) supply of equipment under the assignment contract was its only business during the year; (c) the taxpayer was not financially or technically capable; and (d) the taxpayer supplied the equipment manufactured by the Group companies at half of its purchase price, upheld the TO's conclusion that the taxpayer was a paper company incorporated to evade taxes. Therefore, the Canadian company and the taxpayer were held to be a single entity.

The Indian company was held to constitute a fixed place of business of the taxpayer, as it helped the taxpayer in fulfilling its obligation of installation, commissioning, etc., and the Group's employees who visited India in connection with the project performed the taxpayer's business through premises of the Indian company or the LO.

Certain services were rendered by the taxpayer in addition to the supply of equipment; therefore consideration for equipment supply represented payment for a works contract. The Indian company acted as a sales outlet in providing after sales service and other assistance as requested by the taxpayer.

The CIT(A) concurred with the TO's view in rejecting the accounts furnished by the taxpayer. However, it directed the TO to allow expenses relatable to the PE as deduction in estimating the profits attributable to PE in India. The CIT(A) reduced the attribution to 50% of the profits of the taxpayer's estimated profits to the PE, which was confirmed by the Tribunal.

Held

The HC concurred with the conclusion that the taxpayer was a shadow company of the Canadian company, and assumed that the equipment contract was performed by the Canadian company. Relying on the SC ruling in Ishikawajima-Harima Heavy Industries *v.* DIT [2007] 288 ITR 408 (SC), the HC held that even in cases of turnkey contracts, it was not necessary to consider the entire contract as an integrated one for tax purposes. Thus, the amount paid for overseas supply of equipment would not be chargeable to tax under the Act.

On the issue of transfer of title, it held that the title in equipment was transferred outside India, and possession of equipment by the Indian company till final acceptance by the Indian Telco did not indicate that the taxpayer's income from equipment supply was taxable under the Act. Neither the taxpayer nor the Canadian company performed any installation or commissioning activity in India.

These activities were performed by the Indian company on its own behalf under the contract entered with the customer, and not on behalf of the taxpayer or the Canadian company. The HC found no material on record to indicate that any obligation other than supply of equipment was performed by the taxpayer in lieu of the amounts received. The HC held that no part of the taxpayer's income could be apportioned to operations carried on in India, as there was no material on record, either to hold that the Indian company habitually exercised authority to conclude contracts, or that it maintained stocks in India for regularly delivering goods on behalf of the taxpayer or the Canadian company.

The HC then examined the question of the taxpayer's PE in India for the sake of completeness, and held that there was no material on record to indicate the following:

- the LO acted on behalf of the taxpayer or the Canadian company in concluding contracts on their behalf;
- the office of the Indian company was at the disposal of the taxpayer or the Canadian company;
- the LO or the Indian company acted as a sales outlet of the taxpayer;
- the Indian company performed installation or other services on behalf of the taxpayer.

Considering that a subsidiary company was an independent tax entity and chargeable to tax in the state of its residence, tax payable on Indian company activities should have been captured in its own hands. Thus, income from installation, commissioning, testing and activities performed by Group's expatriate employees seconded to Indian company would be taxable in Indian company's hands, and could not be considered as taxpayer's income.

As income from supply of equipment was not taxable in India, the question of attribution of such income to activities in India did not arise.

Editor's note

The HC reiterated the principle of apportionment as laid down by the SC in the case of Ishikawajima (supra)*, in holding that if no activities were undertaken by the taxpayer in India, then no part of its income could be attributed to the alleged PE in India.*

While concluding and negotiating contracts, the substance in the contracting entity, timing of incorporation of entity, rationale of contract assignment, were factors to be considered; otherwise, the courts could look through and disregard the corporate entity by lifting the corporate veil, in order to determine the taxability.

The judgment emphasises that tax authorities can only attribute profits to activities undertaken in India.

No PE where threshold limit under Article 5(2)(i) of Indo-Mauritius treaty not met for each project independently

ITA No. 4028/ Mum/ 2002 (Mumbai–Tribunal)

Income arising to a Mauritius company from installation of platforms under independent projects/ contracts in India was not taxable in the absence of the taxpayer's PE in India. The Tribunal held that the nine-month threshold for constitution of PE under Article 5(2)(i) of the India-Mauritius tax treaty was not met for each project independently.

Facts

The taxpayer was incorporated in, and a tax resident of, Mauritius. In India, it was engaged in the transportation, installation and construction of off-shore platforms for mineral oil exploration. The taxpayer, in the absence of a PE, filed a nil return of income for the AY 1998-99. The taxpayer executed two contracts in India, from March 1996 to November 1996 and from February 1997 to May 1997. The TO assessed the taxpayer on the basis that it had a PE in India under Article 5(2)(c)(in the form of an LO) and Article 5(2)(i)(Construction PE) of the tax treaty. The TO aggregated the period of installation activities under the two contracts to allege existence of Construction PE. Furthermore, relying on the report of a survey carried out under section 133A of the Act, the TO concluded that the LO premises were used exclusively for the taxpayer's business and therefore that the LO was a fixed place PE. Accordingly, the TO determined the PE's taxable income under section 44BB of the Act. The CIT(A), on perusal of the facts and submissions, held that the taxpayer did not have a construction PE under Article 5(2)(i) of the tax treaty.

However, the CIT(A) upheld the TO's argument that the taxpayer had a fixed place PE since the LO was exclusively used for the taxpayer's projects.

Held

Construction PE

Following its own order of an earlier year, the Tribunal held that since each project duration in India was less than 9 months, the taxpayer did not have a construction PE in India.

Article 5(1) of the tax treaty laid down the general rule regarding the existence of a PE. However, Article 5(2)(i) substituted and limited the permanence test with the duration test. Thus, even if there existed a PE under the general rule of Article 5(1), it would be outside the ambit of the definition of PE by virtue of Article 5(2)(i). A plain reading of Article 5(2)(i) showed that the activities of a foreign enterprise on a particular site or a particular project, or supervisory activity connected therewith, had to be taken into account, and not all the activities in a tax jurisdiction as a whole. There was no specific mention about aggregating the number of days spent on various sites, projects or activities. Each building site, construction or assembly project or supervisory activity in connection therewith had to be viewed on standalone basis. However, certain tax treaties (Australia, Austria, Belgium, Bulgaria, Canada, China, Denmark, Italy, New Zealand, Norway, Spain, Turkey and USA) with India provided for aggregation of days to compute the threshold period. Thus, the aggregation principle could not be read into tax treaties that did not specifically provide for the same. Even while aggregating days, double counting of days (when more than one site or project existed, or when work was carried out at two or more different places on a single day) had to be excluded.

LO as PE

The tax authorities had not appreciated the survey documents completely. Furthermore, none of the documents show that the employees of the LO negotiated or concluded contracts for the taxpayer, or that substantive business was carried out from the LO. The survey documents depicted that the LO merely provided co-ordination, liaison, and back office support activities. Such activities were preparatory and auxiliary in nature, and did not constitute PE under Article 5(2)(c) read with Article 5(3)(e) [UAE Exchange Centre Limited *v.* UOI [2009] 313 ITR 94 (Delhi); DIT *v.* Morgan Stanley [2007] 292 ITR 416 (SC)]. The taxpayer did not carry on any other activity (having an independent identity or economic substance and yielding separate business profits) other than the installation/ construction project. Therefore, the taxpayer's case needed to be considered only under Article 5(2)(i) and not under any other clause [National Petroleum Construction Company *v.* DIT (ITA no. 143/ 2013)(Delhi); Cal Dive Marine Construction (Mauritius) Limited *v.* DIT [2009] 182 Taxman 124 (AAR); Kreuz Subsea Pte. Limited *v.* DDIT [2015] 58 taxmann.com 371 (Mumbai-Tribunal); CIT *v.* BKI/ Ham [2011] 15 taxmann.com 102 (Uttarakhand)].

Editor's note

This is a welcome decision that has thrown light on the interpretation of PE rules. The Tribunal has clarified that where taxpayers have multiple projects, each project ought to be tested for the threshold of duration test. Furthermore, where, under specific tax treaties, the period is to be aggregated, overlap days had to be excluded while computing the threshold period. The Tribunal has also reinforced the principle that where a specific PE is alleged (like construction PE), then it ought to be tested only under that specific paragraph, and not under the general provisions.

Royalty

Payments under non-exclusive license towards the right to use information embedded in the copyrighted product not taxable as "royalty"

ITA No. 317 & 318/ Hyd/ 2012 (Hyderabad-Tribunal)

License fee paid to foreign entities (incorporated in the US and the UK) under a non-exclusive license obtained granting access to dataset that is not exclusively customised to meet the taxpayer's requirement does not amount to royalty under the respective tax treaty.

Facts

The taxpayer was engaged in the business of oil and gas exploration. During the course of bidding for the oil and gas exploration block, the taxpayer was required to understand the

geological and seismic quality of the block in order to optimise the risk of exploration and acquire the geological and seismic data. For this, the taxpayer entered into a "Master Geophysical Data Use License and Supplemental Agreement" (the agreement) with two foreign entities, namely, GXT – a US-based company – and GGS – a UK-based company, to understand the geographical quality of the block it was bidding for. By virtue of these agreements, both companies agreed to grant non-exclusive right/ license to the taxpayer to use certain data and derivatives in consideration for the agreed license fee. The taxpayer paid the license fees to the GXT and GGS without withholding tax under section 195 of the Act. GXT had named the data and derivatives given for use under the non-exclusive license as IndiaSPAN. The revenue authorities found that IndiaSPAN had knowledge of the hydrocarbon geology of the east and west coasts of India, derived from the domain experience of GXT in the field of exploration geology/ geophysics and hydrocarbon exploration, and amounted to information concerning industrial, commercial and scientific experience.

The revenue authorities observed that this data was proprietary to, and a trade secret of GXT, and was not divulged to the public. The lower revenue authorities held that the above information/ knowledge was available to the user only on securing a valid license, and therefore, the payment made by way of "license fee" amounted to consideration towards information concerning industrial, commercial or scientific experience and as such constituted "royalty" both under the provisions of the India–US tax treaty and the Act.

The lower revenue authorities also held that the license fee paid by the taxpayer was towards the use of copyright in the dataset, and therefore, the payment made for use of such copyright was in the nature of "royalty." On the same grounds as contended in respect of the payments made to GXT, the lower revenue authorities held the license fee paid to GGS to be in the nature of "royalty." They concluded the taxpayer to be a "taxpayer-in-default" under section 201(1) of the Act, since the taxpayer failed to withhold taxes under section 195 of the Act.

Held

The Tribunal observed that the taxpayer obtained a license for 40 years to use the product IndiaSPAN, a highly technical and complex product, and data therein could only be accessed on grant of license by the owner. Licence was given for a fixed period, on whose expiry, the taxpayer was required to return the product or destroy the data accessed during the license period, but was not required to destroy the product produced by the taxpayer by use of such data. Thus, it was clear that access to the technical knowledge acquired by GXT was granted to the taxpayer in order to enable it to process the same and use such data for furtherance of its object. The definition of "royalty" under the Act was more exhaustive as compared to the definition under the India-US tax treaty and India-UK tax treaty. Thus, the definition under tax treaty being more beneficial to taxpayer over the Act was applied to examine whether the transaction falls within the ambit of said definitions of royalty. The Tribunal concurred with the principle laid down in the cases referred to by the taxpayer, that unless and until the license was given to use the copyright itself, and not just the copyrighted property, the consideration paid could not be treated as "royalty." The Tribunal ruled that the license was granted to use certain data periodically upon the terms and conditions set in the license agreement. It was observed that both the licenses were non-exclusive, and therefore, the data/ information was not customised to meet the taxpayer's requirements exclusively.

Further, the Tribunal observed that the licensors had only made available the data acquired by, and available with them, but they were not making available any technology available for use of such data by the taxpayer. It was noted that licensors were not responsible for the accuracy or usefulness of the data. Thus, the Tribunal ruled that the payments made by the taxpayer were not in the nature of "royalty" as per the respective tax treaties; hence, section 195 of the Act was not applicable, considering the facts of the case.

Editor's note

- *The Tribunal accepted the taxpayer's reliance on Wipro Limited v. ITO [2005] 94 ITD 9 (Bangalore-Tribunal); however, the said judgment has been reversed by the Karnataka HC. The HC held that the payments made to obtain the license to use/ access the online database were in the nature of royalty as it amounted to transfer of right to use the copyright.*
- *The decision in the present ruling seems to be focusing on the premise that only the data was made available to the taxpayer and not the technology for use of such data given that the dataset was not customised for the taxpayer, being given under non-exclusive license and that the taxpayer was liable to return/ destroy the dataset on termination/ expiry of license.*
- *In the present ruling, the taxpayer's contention that the industrial/ commercial/ scientific/ technical experience was not imparted by GXT and GGS to the taxpayer was impliedly accepted, and thus it was held that the payments under the non-exclusive license would not constitute "royalty".*
- *However, there is a negative precedent, viz; in the cases of ONGC Videsh Limited v. ITO [2013] 31 taxmann.com 119 (Delhi-Tribunal) and ONGC Videsh Limited v. ITO [ITA 835/ 2015] (Delhi) on a similar set of facts and issues, wherein the underlying payments were held by the Tribunal to be in the nature of royalty on the premise that "taxpayer" in that case was using the technical experience of the licensor in accessing the online website. Although this Tribunal decision was reversed by the HC, however, the issue of "information royalty" was not adjudicated by the court and was kept open. Thus, the decision of the Tribunal on the characterisation of payments made as "royalty" remains valid even today.*

The taxpayer needs to proceed with caution while adopting the aforesaid position with respect to the non-applicability of withholding taxes on payment of license fees for using the information embedded in the copyrighted product/ property. The possibility of dispute with the revenue authorities in this regard should be borne in mind and cannot be ruled out.

Receipts under "Management and Administrative Services' Agreement" for provision of composite services constitute royalties for a UK resident taxpayer

IT (TP) Appeal No. 6 of 2011 (Bangalore–Tribunal)

Amount received by a UK resident company for providing services to an Indian group company under a "Management and Administrative Services" (MAS) agreement constituted royalties under the Act read with the India–UK tax treaty.

Facts

The taxpayer, a tax resident of UK, was internationally engaged in the business of express distribution of freight, parcels and documents. It entered into an MAS agreement with an Indian group company, under which the taxpayer provided certain services. The taxpayer did not have a PE in India. The taxpayer received a fee from the Indian company for rendering these services. It filed its return of income in India, declaring a non-taxable position and claiming a refund of the taxes withheld by the Indian company. The TO observed that some services provided by the taxpayer that involved provision of information such as sales support, liaising with professional advisors, lobbying activities and coordination with trade associations may not strictly be in the nature of supply of know-how, and so would fall within the purview of the definition of royalty/ royalties under the Act/ tax treaty (hereinafter collectively referred to as "Royalties"). However, the TO noted that commercial information provided by the taxpayer to the Indian company arose from previous experience that definitely had practical application in the enterprise's operations, and from which an economic benefit could be derived, and therefore, the services were in the nature of royalty. In the absence of a breakup of payments received by the taxpayer for various services/ information covered under the MAS agreement, and also in the absence of information on costs incurred by the taxpayer in rendering the services, the TO concluded (in the draft assessment order) that the composite services provided by the taxpayer were in the nature of supply of commercial information concerning commercial experience, and could therefore be characterised as royalties. The taxpayer filed an appeal before the Bangalore Tribunal against the final assessment order.

Held

The Tribunal analysed the relevant clauses of the MAS agreement and noted that as per the agreement, the taxpayer provided two types of services: one on which direct costs were incurred, and the other on which no such direct costs were incurred, and consideration for providing the services was charged based on gross revenue. It was clear that the services under the second category were definitely not specifically developed or designed for the purpose of providing the services to the Indian company, but may already have been be in existence. Through only the nomenclature of these services, it could not be ascertained whether the provision of these services were in the nature of imparting knowledge, experience, information concerning industrial, commercial or scientific experience or skill.

The Tribunal considered the definition of "royalties" under section 9(1)(vi) of the Act and under Article 13(3) of the India-UK tax treaty, and observed that broadly, there was no difference between the definitions of royalties as given under the Act and under the India-UK tax treaty.

The Tribunal observed that there was no argument that where the taxpayer was using the experience and expertise itself for providing the services in the form of a report or design developed specifically for an Indian entity that was not already in existence, then the provision of such a report, plan or design by using the expertise, information or experience, would therefore not fall under the purview of royalties.

It observed that it was not the nomenclature of the agreement, but the substance and contents, and the terms and conditions of the agreement that determined the real intentions and nature of the mutual obligations of the parties. The Tribunal referred to the various services provided under the MAS agreement and the confidentiality clause, and opined that some of the services were clearly for new process information, including specification and application, evaluation of new opportunities, management information and other automatic system services, which may be the taxpayer's own expertise and experience and acquired during the course of time. Therefore, these services, *prima facie,* appeared to be in existence and were being provided in the form of information that was definitely related to the commercial and business activities of the Indian entity.

The Tribunal also referred to the Commentary on the OECD Model Tax Convention for determining the characterisation of the payment, and observed that Para. 10.2 thereof reiterated the concept of imparting knowledge; however, if the payment was received for the development of a design, model or plan that did not already exist, then the development of such design, model or plan by using its own experience or expertise, skill or know-how would not constitute imparting of knowledge, experience or know-how; the payment, therefore, was simply for execution of work and could not be said to execute royalties. On the contrary, if the payment was received to supply existing information or reproduce existing material, then it would constitute imparting of information to fall under the purview of royalties.

The Tribunal concluded that though the agreement was for the provision of composite services, certain services were purely business/ commercial contract services, whereas other services were in the nature of imparting of knowledge, experience and expertise. Since the taxpayer had failed to provide a bifurcation of the payment for each type of service, the Tribunal, relying on Para. 11.6 of the OECD Model Tax Convention, held that the other part of the services was to be given the same tax treatment as to one part of the services provided, which constituted the "principal purpose" of the contract and fell under the purview of royalties. This was because a reasonable apportionment was not possible. Accordingly, the Tribunal held that the Revenue was correct in treating the entire consideration received by the taxpayer as royalties.

Editor's note

This is yet another ruling on the issue of what constitutes consideration for information concerning industrial, commercial or scientific experience for the purpose of Article 13 of the India-UK tax treaty. First, in the instant case, while the Tribunal has observed that, broadly, there is no difference between the definition of "Royalty" under the Act and "Royalties" under the India-UK tax treaty, it is pertinent to note that while the definition under the Act contains the words, "imparting of" any information

concerning, the India-UK tax treaty does not contain these words. One would need to duly evaluate whether the aforesaid words as contained in the Act carry/ ought to be given any particular weightage and consideration while evaluating the characterisation of payments under the head "royalties."

While the Tribunal has referred to the judgments rendered by the Bombay HC in the case of Diamond Services International Private Limited v. UOI & Ors [2008] 304 ITR 201(Bombay) and the Mumbai Tribunal in the case of GECF Asia Limited v. DDIT [2014] 34 ITR 303 (Mumbai-Tribunal) as relied upon by the taxpayer, while rendering its view, it has proceeded on the footing that the agreement was a composite one comprising some services that were purely of a business/ commercial nature and others that were in the nature of imparting knowledge and experience. The Tribunal has not expressly analysed the judgments in the context of the taxpayer's facts and has also not sought to distinguish the judgments that are favourable to the taxpayer.

The ruling once again reiterates the need for taxpayers to maintain robust documentation/ details in support of the services provided by them/ consideration received under any Service Agreement.

Indian distributor of a non-resident channel company not a PE and revenue from distribution of channels in India not chargeable to tax as royalty

[2016] 72 taxmann.com 143 (Mumbai-Tribunal)

Subsidiary Indian company distributor did not constitute an agency PE of the non-resident channel company engaged in broadcasting of sports channels worldwide. Further, revenue received from the distribution of channels in India did not amount to royalty under the India-Mauritius tax treaty.

Facts

The taxpayer was initially registered as a company in the British Virgin Islands. During the year, the taxpayer re-registered under the laws of Mauritius, and accordingly became a tax resident of Mauritius for part of the year. The taxpayer was engaged in the business of broadcasting a sports channel around the world, including India. The taxpayer had appointed its subsidiary in India (Indian distributor) to undertake the following activities under two separate agreements:

- Act as the taxpayer's advertising sales agent to sell advertisement slots to prospective advertisers and other parties in India, and collect advertising revenue for a commission of 10% of the total advertisement revenue secured for the taxpayer; and
- Distribute pay channels to cable operators under a revenue share, where 40% of the total distribution revenue would be retained by the Indian distributor and the balance would be paid to the taxpayer as distribution income.

The taxpayer filed its return of income in India without offering any income to tax in India, on the basis that the advertising and distribution revenue earned were not taxable in India in the absence of a PE. As an alternative, the taxpayer argued that as per the accounts pertaining to the India operations audited under section 44AB of the Act, losses had been incurred, and therefore, no income was chargeable to tax in India. The TO, however, held that the Indian subsidiary of the taxpayer was acting as an agent for the sale of advertisement slots to Indian advertisers. Hence, the Indian subsidiary was an agency PE of the taxpayer in India under Article 5(4) of the India-Mauritius tax treaty. In connection with the distribution income, the TO concluded the following:

(a) For the period during which the taxpayer was a resident of the British Virgin Islands, distribution income was taxable in India as royalty under section 9(1)(vi) of the Act; and

(b) For the period during which the taxpayer was a resident of Mauritius, distribution income was attributable to the PE and was therefore chargeable to tax as business income under Article 7 of the India-Mauritius tax treaty.

While computing the income attributable to the PE of the taxpayer in India, the TO disallowed the following payments made by the taxpayer to non-residents under section 40(a)(i) of the Act, for not withholding taxes, on the basis that such payments were chargeable to tax in India as royalty under section 9(1)(vi) of the Act:

(a) *Programming cost* paid to cricket boards and other sports associations for acquiring live telecast rights for events outside India, holding it to be copyright in respect of the events;

(b) *Transponder fee* paid for procuring services through satellite located outside India, holding it to be fee for use or right to use any industrial, commercial and scientific equipment; and

(c) *Uplinking charges* paid for procuring services of uplinking signals from the venue of the live events taking place outside India to the satellite, holding it to be fee for use or right to use any industrial, commercial and scientific equipment.

The CIT(A) upheld the TO's order in terms of the taxability of advertisement revenue as business income. However, the CIT(A) held that the distribution income was not taxable in India. The CIT(A) reversed the disallowance made by the TO under section 40(a)(i) of the Act, as the payments made by the taxpayer were not chargeable to tax in India as royalty. The Revenue filed an appeal against the CIT(A)'s order *qua* distribution income and reversal of disallowances, while the taxpayer filed an appeal before the Tribunal *qua* the taxability of advertising income. There was a delay by the taxpayer in filing the appeal before the Tribunal regarding advertising income that was not condoned by the Tribunal. Hence, the only issue before the Tribunal was with respect to the taxability of distribution income and disallowance of payments under section 40(a)(i) of the Act in arriving at the income taxable under Article 7.

Held

Distribution income

In the absence of any material to the contrary, the Tribunal affirmed the view of CIT(A) that based on the distribution agreement and sub-distributor agreement placed on record, the Indian distributor was not acting as the taxpayer's agent. An agent could be said to be dependent if the commercial activity of the enterprise was subject to instructions or comprehensive control, and if the enterprise did not bear entrepreneurial risk. An agency PE was established if the agent had sufficient authority to bind the foreign enterprise's participation in the business activity. The Indian distributor did not constitute an agency PE of the taxpayer under Article 5(4) of the India-Mauritius tax treaty as it was acting independently *qua* the distribution rights, and the distribution agreement with the taxpayer was on a principal-to-principal basis. The TO's divergent views in terms of the distribution income being taxable as royalty for part of the year and as business income for the other part of the year were not upheld. In any case, under the distribution agreement, the taxpayer had not granted any license to use any copyright to the Indian distributor or the cable operators. The taxpayer only made available the content to the cable operators that was to be transmitted to the end viewer, and the rights to such content belonged to the taxpayer. Therefore, distribution income could not be held as royalty. The decision in the case of NGC Network Asia LLC *v.* Jt. DIT [2015] 64 taxmann.com 289 (Mumbai-Tribunal) could not be relied upon, because in that case, the issue of taxability of distribution income was set aside to examine whether it could be categorised as royalty. In the present case, the TO had treated the distribution revenue as business income for the latter part of the year and for subsequent years.

Disallowances under section 40(a)(i)

Definition of royalty under the India-USA tax treaty was exhaustive and therefore no definition under the Act was required to be considered that extended the operation of the term defined in the India-USA tax treaty, whether prospective or retrospective. The legislature could not supersede or control the meaning of this term that had been expressly defined in the tax treaty negotiated between two sovereign nations. Transponder charges and uplinking charges paid could not be treated as consideration for use or right to use any copyright of a literary, artistic, or scientific work, including cinematographic films or work on film, tape or other means of reproduction for use in connection with the radio or television broadcasting or in any manner relates to any trademark, design, secret formula or process as required under Article 12 of the India-USA tax treaty.

The Tribunal following the decision in the case of DIT *v*. New Skies Satellite BV [2016] 68 taxmann.com 8 (Delhi), which had also taken into consideration the case of Verizon Communications Singapore Pte Limited *v.* ITO [2104] 361 ITR 575 (Madras), held that the

extended definition of royalty under the Act would not impact the interpretation of royalty under Article 12 of the India-USA tax treaty. In any case, the Tribunal relied on the legal maxim *"lex non cogit ad impossibilia"* and held that the law could not possibly compel a person to do something impossible, that is, when there was no provision for taxing an amount in India, then tax could not be expected to be deducted on such payment. Therefore, retrospective amendment to the definition of the term "royalty" would not retrospectively affect the withholding tax obligations of the taxpayer. The Tribunal relied on the decision of Channel Guide India Limited *v.* ACIT [2012] 139 ITD 49 (Mumbai-Tribunal). The Tribunal relied upon the decision in the taxpayer's own case and held that the programming cost paid to foreign sports associations for events held outside India were not taxable in India, as the same could not be deemed to arise in India nor were they borne by any PE in India.

Editor's note

The Tribunal, in the present case, based on the India-Mauritius tax treaty held that a foreign channel company did not have a dependent agent PE in India, as the group company appointed in India to distribute the channels was independent in its operations qua *distribution activity. The Tribunal considered the distribution agreement (which was on a principal-to-principal basis) and the entrepreneurial risk borne by the Indian distributor to determine if the taxpayer had a PE in India.*

The Tribunal has held that distribution income was not in the nature of royalty in case no rights in the content distributed had been transferred. Separately, in terms of determining whether payment for transponder charges qualifies as royalty, the Tribunal had relied on favourable judgments which held that the extended definition of royalty, post the retrospective amendments, would not impact the interpretation of royalty under the treaties. There were contradictory rulings on this matter. The Tribunal ruling in the present case could further strengthen the taxpayers' case.

Fees for technical services

Restrictive definition of FTS in the India-Portugal treaty does not automatically apply to the India-Switzerland tax treaty by virtue of the MFN clause

ITA No. 451/ Ahd/ 2012 (Ahmedabad-Tribunal)

Automatic access to the restrictive definition of FTS would not be available/ granted in the context of consultancy fees paid to a Switzerland-based company. The MFN clause in the India-Swiss Confederation tax treaty required a re-negotiation of the tax treaty with the Swiss Confederation when India entered into a tax treaty with a third state (which was a member of the OECD) restricting the scope of the FTS.

Facts

The taxpayer, a company resident in India, was engaged in the manufacture and marketing of pharmaceutical products. During the assessment year 2008-09, the taxpayer remitted certain payments towards professional and consultancy services to overseas payees who were tax residents of Switzerland, Canada and the United States. Such payments were for conducting tests/ studies for research on samples forwarded by the taxpayer. The taxpayer remitted the fees to such payees without withholding tax in India. Relying on tax treaties with the respective countries, the taxpayer claimed that the payees had not "made available" any technical knowledge, experience, skill, knowhow or processes that enabled it to apply the technology contained therein. The TO passed an order under sections 201 and 201(1A) of the Act, holding that the aforementioned payments were in the nature of royalty/ FTS covered under sections 9(1)(vi) and (vii) of the Act, and were hence liable to tax in India, and rejected the taxpayer's reliance on the respective tax treaties. Aggrieved, the taxpayer filed an appeal before the CIT (A). With respect to the Swiss remittances, the CIT (A) rejected the taxpayer's claim on the following grounds:

- Swiss remittance was towards FTS covered under section 9(1)(vii) of the Act and Article 12 of the India-Swiss tax treaty.
- The MFN clause in the India-Swiss Confederation tax treaty provides that the scope of FTS would have to be re-negotiated if it was restricted in a subsequent treaty entered into by India with an OECD member state. Hence, the said clause was of no avail unless the India-Swiss tax treaty was re-negotiated.

With respect to the Canadian and US remittances, the CIT (A) granted relief to the taxpayer, concluding that the services did not make available technical knowledge, experience, skill, knowhow or processes that enabled the person acquiring the services to apply the technology contained therein. The taxpayer and the Revenue both filed appeals before the Tribunal, against the applicability of withholding tax on the Swiss remittances and the Canadian and US remittances, respectively.

Held

With respect to the Swiss remittances, the Tribunal observed that the 'make available' clause was not present in Article 12 – FTS under the India-Swiss Confederation tax treaty. The Protocol to the India-Swiss Confederation tax treaty only mentioned that both countries should enter into negotiations if India entered into a tax treaty with a third state that was a member of the OECD, restricting the scope of FTS. In the absence of re-negotiation of the treaty, the restricted scope of FTS as per the India-Portugal tax treaty could not be applied to the India-Swiss Confederation tax treaty.

The Tribunal observed that the taxpayer's reliance on the Sandvik AB *v.* DDIT [2015] 167 TTJ 217 (Pune) was misplaced, since the Protocol to the India-Sweden tax treaty regarding a beneficial rate or scope did not have the condition of re-negotiation between the two countries (unlike the India-Swiss Confederation tax treaty). Accordingly, the Tribunal upheld the decision of the lower authorities that the restricted scope of FTS as per the India-Portugal tax treaty could not be applied to the India-Swiss Confederation tax treaty. With respect to the Canadian and US remittances, the Tribunal observed that the Revenue failed to produce any evidence that the payees had made available any technical knowledge, experience, skill, knowhow or processes to the taxpayer, which enabled the taxpayer to independently apply the technology contained therein. Based on this, the Tribunal noticed that these payees had merely rendered consultancy services without imparting any knowledge. Accordingly, the Tribunal upheld the decision of the lower authorities.

Editor's note

The MFN clause in the protocol to tax treaties with most countries (e.g., Sweden, France and Spain) does not require re-negotiation of the tax treaty. However, the MFN clause in the Protocol to the India-Swiss Confederation tax treaty requires re-negotiation of the tax treaty. Furthermore, it may be noted that the Protocol to the India-Swiss Confederation tax treaty has been amended with effect from 1 April, 2012 (the amended protocol was signed on 30 August, 2010). After this amendment, re-negotiation of the India-Swiss Confederation tax treaty is no longer required for availing the lower tax rate by virtue of the MFN clause. Nonetheless, the necessity to re-negotiate continues to be a prerequisite to avail the benefit of a restricted scope of FTS under the treaty. Since 30 August, 2010, India has not signed any tax treaty with any OECD member country that contains a more restrictive definition of FTS.

Fees for included services

Programme fees received by non-profit US University for education programmes in India not taxable as FIS or as business income

AAR No. 1656 of 2014 (New Delhi)

Fees received by a non-profit US university for carrying out management education programmes in India would not be taxable as FIS/ royalties under the India-USA tax treaty. The fees would not be taxable as business profits under Article 7 of the tax treaty since the applicant was registered in the USA as a non-profit public benefit corporation, and its activities in India could not have been said to be business activities. Hence on this ground itself, provisions of Article 7 of the tax treaty would not be applicable. Thus, the AAR ruled that the applicant did not have a PE in India per Article 5 of the tax treaty.

Facts

The applicant, a non-profit, public benefit corporation formed for the purpose of providing education, entered into an agreement with N Limited for launching a management education programme in India. The programme duration was for 60 days and consisted of various modules of varying duration. The applicant agreed to send its professors to train senior executives of companies who had a minimum work experience of eight years. As per the agreement between the applicant and N Limited, the latter was to arrange the location for conducting these programmes

in India. The applicant had clarified that its relationship with N Limited was neither that of an independent contractor nor in the nature of a joint venture, employment agency or partnership.

Held

The AAR, relying on its earlier ruling for UC Berkeley Centre for Executive Education, USA, ruled that the applicant's activities, being educational in nature, would not be covered under the scope of FIS under Article 12 of the tax treaty. The AAR also noted that the Revenue did not raise any serious objections to the fact that the applicant's activity was educational and hence directly covered under Article 12(5)(c) of the tax treaty. The AAR relied on its earlier rulings for UC Berkeley Centre for Executive Education, USA and Eruditus Education Private Limited [AAR 1037 of 2011 dated 20 September, 2011], and held that the applicant's activities in India could not have been considered as business activities, as the applicant was registered in the USA as a non-profit, public benefit corporation formed for providing education. The Revenue's reliance on Article 7 was uncalled for, as Article 7 dealt only with business income. There could be no fixed place PE in India, as every time the programme was undertaken, N Limited arranged for the location, which need not have been the same every time: the programme could have been conducted at different locations. The AAR noted that the applicant made available the programmes of the Harvard Publishing University, which publishes material worldwide. Therefore, the amounts received by the applicant could not be considered as royalty.

Editor's note

This ruling is consistent with the stand taken by the AAR in its earlier rulings that amounts received by an educational institution would not constitute FIS per Article 12(5)(c) of the tax treaty. The AAR has given a categorical finding that an educational institution set up as a non-profit organisation could not be considered as being in the "business" of providing education, and accordingly, the amounts received would not come within the scope of Article 7 of the tax treaty.

Tax treaty

Protocol is an integral part of the tax treaty – need not be separately notified; Restrictive definition of India-UK tax treaty can be read into India-France tax treaty

W.P. (C) 4793/ 2014& CM APPL. 9551/ 2014 (Delhi)

The Protocol to a tax treaty is its integral part. Accordingly, by virtue of clause 7 of the Protocol to India-France tax treaty, the restrictive definition of FTS appearing in the India-UK tax treaty must be read as formative part of the India-France tax treaty. Thus, managerial services provided by the French entity would not fall within the ambit of FTS under the India-France tax treaty.

Facts

The taxpayer was a public company registered in India, providing IT-driven services for its clients' core businesses. An MSA was entered into on 01 January, 2009 between the taxpayer and a French Group entity, under which the French entity was to provide various management services to the taxpayer with a view to rationalise and standardise the taxpayer's business in India. Services under the broad category of General Management Services included Corporate Communication Services, Group Marketing Services, Development Services, Information System and Services, Legal Services, Human Relation Services etc. These services were rendered by the French entity through telephone, fax, e-mail, and no personnel of the French entity visited India for providing such services.

The French entity, a limited liability partnership firm incorporated in France, centralised skills for carrying on management functions such as legal finance, human resources, communication risk control, information systems, and management information services. It did not have a PE in India under the provisions of the India-France tax treaty. The taxpayer had sought a ruling from the AAR on whether the payments made by it for management services provided by the French entity were taxable in India under the provisions of the India-France tax treaty, and whether the taxpayer was required to withhold taxes on such payments under section 195 of the Act.

Held

Protocol- integral part of the tax treaties

The HC did not endorse the restrictive interpretation placed on Clause 7 of the Protocol to the India-France tax treaty, and held that the words, "a rate lower or a scope more restricted" in the Protocol envisaged that there could be a benefit of either kind, i.e., a lower rate or a more restricted scope. One did not exclude the other. The purpose of Clause 7 of the Protocol, the HC held, was to afford to a party to the India-France tax treaty, the most beneficial of the provisions that might be available in any convention between India and another OECD country. The wording of Clause 7 of the Protocol made it self-operational. The Preamble in the Protocol stated, "*the undersigned have agreed on the following provisions which shall form an integral part of the Convention*". This extract made the position clear that the Protocol signed between India and France simultaneously formed an integral part of the tax treaty. Once the tax treaty had itself been notified and contained the Protocol, including Clause 7 thereof, there was no need for the Protocol to be separately notified.

The taxpayer relied on the decision of the Kolkata Tribunal in the case of DCIT *v*. ITC Limited [2002] 82 ITD 239 (Kolkata-Tribunal), wherein the Protocol executed between India and France was interpreted. The HC disagreed with the AAR's conclusion that a separate notification incorporating the beneficial provisions of the India-UK tax treaty as forming part of the India-France tax treaty was required. It therefore held that the benefit of the lower rate or restricted scope of FTS under the India-France tax treaty was not dependent on any further action by the respective governments. The more restricted scope of FTS as provided for in a tax treaty entered into by India with another OECD member country shall also apply under the India-France tax treaty with effect from the date on which the India-France tax treaty or such other tax treaty enters into force.

Taxability of managerial charges paid to French entity

The definition of FTS in Article 13(4) of the India-UK tax treaty clearly excluded managerial services. It was clear that once the expression, "managerial services" was outside the ambit of FTS, the taxpayer's question about having to withhold tax from payment for the same would not arise. It was therefore not necessary to examine the second limb of the definition, i.e., whether the services were "made available" to the taxpayer. On the Revenue's contention raised regarding the French entity having a PE in India and its income being taxable under Article 7 of the India-France tax treaty, the HC held that the question whether the French entity had a PE in India would arise only if the Revenue contended that the French entity earned any business income in India. Since it was projected that the fee paid by taxpayer to the French entity partook the character of FTS, the question whether the French entity had a PE in India under Article 7 of the India-France tax treaty did not arise.

The HC concluded that the payment made by the taxpayer to the French entity for managerial services could not be taxed as FTS, and hence, these payments were not liable to withholding tax under section 195 of the Act.

Editor's note

This is a welcome decision from the HC, as it emphasises that the Protocol is an integral part of the tax treaty itself, and that no separate notification is required to give effect to the beneficial provisions of the Protocol, unless specifically agreed upon under the Protocol. The Protocol to certain other tax treaties such as the India-Philippines and India-Switzerland have a MFN clause. However, they specifically require a notification to be issued to make the Protocol operative. No such requirement exists under the India-France tax treaty. It may be prudent to examine the relevant tax treaty before applying the MFN clause.

Tax avoidance

Transfer of shares of an Indian company from Mauritius to Singapore within the group held not taxable, Revenue's contention that the transfer is scheme for tax avoidance rejected

AAR No. 1123 of 2011

Transfer of shares of an Indian company by the Mauritius parent to a Singapore group company was not taxable on account of the beneficial provisions of Article 13(4) of the India-Mauritius tax treaty. Such an arrangement could not be a scheme for tax avoidance on account of business considerations pleaded by the Mauritius entity. In the absence

of taxable income, there was no requirement for (1) the Singapore entity to withhold tax at source, (2) the Mauritius entity to file a return of income, and (3) the Mauritius entity to undertake transfer pricing compliances.

Facts

The applicant, a company incorporated in Mauritius (Mauritius Co), was a part of a group of companies (Group) with its parent company in the United States of America (US Co). Mauritius Co had acquired 99.99% equity shares of the Indian group company (Indian Co) between the years 1995 and 2005.The remaining 200 shares were held by another group company. Mauritius Co had proposed to transfer its entire shareholding in Indian Co to a new Singapore entity of the Group Company (Singapore Co) that would be set up as 100% subsidiary of Mauritius Co. This transfer was proposed to be undertaken for a group re-organisation.

- Post 2010, the Group had been realigned into four areas based on geographical locations i.e. North America, South America, Europe and Asia Pacific.
- Re-alignment was undertaken with the intention to reduce complexities, improve efficiency and reduce costs.
- Post re-alignment, Mauritius Co formed a part of Europe area, but Indian Co became a part Asia Pacific area which included China and other South East Asian countries.
- Singapore Co was proposed as the holding company of Indian Co, for achieving better control, operational excellence and administrative convenience (as both now were part of Asia Pacific area).

Held

Issue 1 – Question by the Revenue Authorities - whether a tax avoidance arrangement

The applicant contended that the investments were made in the Indian Co by the Mauritius Co after obtaining necessary approvals from the DIPP and RBI. Investments in India through a Mauritius entity, based on principles of treaty shopping, could not be characterised as a tax avoidance arrangement. For this, the applicant relied on Vodafone International Holdings BV *v.* UOI [2012] 341 ITR 1 (SC) and UOI *v.* Azadi Bachao Andolan [2003] 263 ITR 706 (SC). Post-acquisition till date, the shares were held by the applicant as an investment. There were no transactions in these shares for five years after the last acquisition, until business reorganisation was proposed in 2010. Further, the AAR noted that the Mauritius Co had been an operational entity for more than 10 years and that the transaction with Singapore Co was necessitated due to business considerations, and hence should not be seen as a "tax avoidance" scheme.

Issue 2: Capital asset v. Stock-in-trade; tax treatment of capital gains; existence of PE

Capital asset v. Stock-in-trade, taxability of capital gains

The applicant contended that the shares of India Co. held by the applicant should have been considered as "capital asset" and not as "stock-in-trade." The applicant contended this in view of Instruction no. 1827, circular no. 4 of 2007, and relevant jurisprudence [G Venkata Swami Naidu *v.* CIT [1959] 35 ITR 594 (SC), Raja Bahadur Kamakhya Narain Singh *v.* CIT [1970] 77 ITR 253 (SC) and the AAR ruling in the case of Praxair Pacific Limited, *In re* (AAR No. 855 of 2009)] that prescribe three broad tests (accounting test, intention test and quantum test). The tests have been prescribed to determine whether the shares were held as capital asset or stock-in-trade. Accordingly, capital gains arising on transfer of "capital asset" were held to be not taxable in India, given the beneficial provisions of Article 13(4) of the tax treaty.

Existence of PE

The applicant contended that it did not have a PE in India, and produced its certificate issued by the Registrar of Companies in Mauritius, a TRC, and a self-declaration that it had no PE. The applicant also reiterated that it did not have any employees, agents or permanent office to operate from in India. The AAR noted that the Revenue authorities did not bring any material on record to substantiate that either Mauritius Co or US Co had a PE in India. Therefore, the AAR rejected their contentions.

The AAR answered all the three questions in favour of applicant relying on JSH Mauritius Limited, *In re* [AAR No. 995 of 2010].

Issue 3: Applicability of section 115JB

The AAR observed that the provisions of section 115JB of the Act were not applicable, based on the Press Release dated 24 September 2015 and the SC decision in Castleton Investments Limited *v.* DIT [2015] 62 taxmann.com 43 (SC).

Issue 4: Applicability of Transfer Pricing provisions

The applicant contended that since the proposed transfer of shares of Indian Co did not result in income chargeable to tax in India, in view of Article 13 of the tax treaty, TP provisions would not be applicable to the proposed transaction. It relied on rulings in the cases of Dana Corporation*, In re* [2010] 227 CTR 441 (AAR), Praxair *(supra)* and Vanenburg Group BV *v.* CIT [2007] 289 ITR 464 (AAR). The AAR agreed with the applicant's submission, and answered in favour of the applicant.

Issue 5: Applicability of withholding tax provisions and return filing requirements

The AAR held that since capital gains arising out of the proposed transfer of shares were not taxable in India, there was no requirement to withhold taxes in this case. The AAR relied on the SC ruling in the case of Transmission Corporation of AP Limited *v.* CIT [1999] 105 Taxman 742 (SC).

The applicant contended that a taxpayer having no liability to pay tax in India was not required to file return of income in India. The applicant relied on rulings in the case of Factset Research Systems Inc., *In re* [2009] 317 ITR 169 (AAR), Vanenburg (*supra*) and Chatturam *v.* CIT [1947] (FC) 15 ITR 302. The AAR noted that the aforesaid rulings relied on by the applicant were not considered in the Castleton's (*supra*) ruling, which was relied on by the Revenue Authorities. Thus, the AAR disagreed with the Castleton (*supra*) ruling with regard to the applicability of section 139(1), and ruled in favour of the applicant.

Editor's note

This ruling continues with the recent trend of rulings, of allowing India-Mauritius tax treaty benefit to Mauritius taxpayers. The fact that the applicant could demonstrate a business rationale for the transfer appears to have been a significant factor in negating allegations of tax avoidance – and paved the way for tax treaty relief. The fact that the transfer appears to have been undertaken at book value (accordingly, no step-up in cost has been recorded for future sale) and the fact that the India-Singapore tax treaty anyway does not provide any greater benefit as compared to the India-Mauritius tax treaty, could have also been relevant factors (though not specifically discussed in the ruling).

Given that the transfer appears to have been undertaken at original cost of acquisition, it would be interesting to consider whether the rigours of section 56(2)(viia) would apply to the Singapore Co.

Separately, it has been a recent practice of many taxpayers to report transactions in the transfer pricing certifications, even though they do not create tax liability or are not taxable. In a situation where a taxpayer decides not to do so, the conclusion of this ruling can support such a position.

Additionally, taxpayers would be willing to employ this argument because no tax return needs filing, consequent to this ruling that income is not liable to tax in India.

Lastly, one should also consider that the taxpayer could successfully argue against the re-characterisation of the consideration if general anti-avoidance rules are invoked.

Business expenditure

Tribunal upholds disallowance of expenditure on doctors' overseas travel incurred by pharma company–provides directions on deductibility of cost of free samples given to doctors

ACIT *v.* Liva Healthcare Limited [2016] 73 taxmann.com 171 (Mumbai-Tribunal)

Disallowed deduction under section 37(1) of the Act for expenses incurred on doctors' foreign tours by a pharmaceutical company. Overseas trips were organised merely to entertain doctors abroad and lure them into soliciting business for the company by unethical, illegal and prohibited means, and hence should be discouraged.

For disallowance of expenses incurred on distribution of free samples to physicians, the Tribunal restored the issue back to the TO for fresh adjudication. The Tribunal has noted that expenditure incurred on the distribution of free samples after introduction of a medicine in the market, when its use was established, was squarely covered by the Explanation to section

37 of the Act, read with the Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 (MCI Regulations).

Facts

Disallowance of expenditure incurred on doctors' overseas tours

The taxpayer was in the business of manufacture and marketing of pharmaceutical formulations, primarily skin care products. During the AY, the taxpayer incurred an expenditure for sponsoring doctors' overseas tour for attending seminars. The taxpayer organised the seminars/ group visits helped in creating a relationship with the doctors, who were expected, in turn, buy or prescribe medicines sold by the taxpayer. Even spouses of the doctors accompanied them on the overseas trips, and the arrangements included cruise travel, gala dinners, cocktails and entertainment. The taxpayer did not bring anything on record (except for photographs of some places) to show that such seminars were actually conducted during the doctors' overseas trips. The TO disallowed these expenses, considering them as expenses not incurred for the purpose of the taxpayer's business. Allowability of such expense was prohibited by the CBDT Circular dated 01 August, 2012, read with the MCI Regulations.

Disallowance of expenditure incurred for distribution of free samples

The taxpayer claimed expenses incurred on distribution of free samples to physicians, which the TO disallowed on the basis that the taxpayer had failed to prove the genuineness of the expenses and its business purpose. According to the taxpayer, samples were provided free of cost to doctors in order to obtain information regarding the efficacy of the medicine and were thereby incurred for the purposes of advertisement, publicity and sales promotion. When such samples were given to the doctors, a certain relationship was created with the doctors, who might then buy or prescribe those medicines in preference to other similar products.

Held

Disallowance of expenditure incurred on doctors' overseas tours

These expenses were against public policy, being unethical and prohibited by law. The MCI Regulations were within the definition of "law," and hence, covered under Explanation to section 37 of the Act. Entertaining doctors abroad and luring doctors to solicit business by unethical, illegal and prohibited means was an offence under Regulation 6.4.1 of the MCI Regulations, and hence was clearly not allowable in view of Explanation to section 37 of the Act. The CBDT circular dated 01 August, 2012 was clarificatory in nature, and applicable retrospectively. Based on the above, the Tribunal dismissed the taxpayer's appeal.

Disallowance of expenditure incurred for distribution of free samples

The Tribunal was of the view that the physicians' samples were necessary to ascertain the efficacy of the medicine and to introduce it in the market for circulation, and it was only by this method that the purpose was achieved. Providing physicians' samples for a reasonable period was essential for the business of manufacture and sales of the medicine. Provision of free sample post establishment of the product in the market was squarely covered by Explanation to section 37 of the Act, and also by the MCI Regulations. For this purpose, the Tribunal relied on the ratio of the SC's decision in the case of Eskayef (now known as Smithkline Beecham) Pharmaceuticals (India) Limited *v.* CIT [2000] 245 ITR 116 (SC), *albeit* rendered in the context of erstwhile section 37(3A) of the Act that stood omitted w.e.f. 01 April, 1986.

The taxpayer was unable to provide a complete list of doctors and their confirmation of receipt of such samples. Further, the taxpayer did not furnish data that could facilitate the correlation of the date of introduction of products with the quantity of samples provided. Therefore, the Tribunal remanded the matter back to the TO for reconsideration.

Editor's note

Disallowance of expenditure incurred for doctors' overseas tours

The Tribunal has clarified that the CBDT circular on allowability of freebies given to doctors is clarificatory in nature, and hence has retrospective effect. The CBDT circular refers to the MCI Regulations as amended on 10 December, 2009.

Disallowance of expenditure incurred for distribution of free samples

The Tribunal has held that the expenditure incurred on the distribution of free samples after introduction of the medicines in the market, when its use is established, are not allowable expenses, although such condition does not seem to specifically arise from any regulation/ guideline.

Income from other sources

Tips are not hotel employees' salary income as employment contract is not proximate cause for such receipts

Civil Appeal No. 4435 to 4444 of 2016 (SC)

Since the employment contract was not the proximate cause for receipt of tips by hotel employees, tips would not be covered under the head "income from salary" under section 15 and 17 (Salary taxation provisions under the Act). Hence, no tax was needed to be withheld when the amounts were paid to the employees. Furthermore, such tips received by hotel employees were their "income from other sources."

Facts

The taxpayer—the employer—was engaged in the hotel business. It collected tips charged to the customers' credit cards and then passed the same over to the employees without withholding any tax thereon. The TO treated such receipt of tips as "income from salary" in the hands of the employees and held that the taxpayer was liable to withhold tax on such payments under section 192 of the Act. On failure to withhold such tax, the TO treated the taxpayer as a "taxpayer-in-default" under section 201(1) of the Act and asked for the tax and interest prescribed under the Act for such failure. The Delhi HC decided the matter against the taxpayer on the basis of the following:

- The tips would amount to "profit in addition to salary or wages" and was covered under the specified provisions of the Act.
- When the employees received the tips in cash, the employer had no role to play and would therefore be outside the withholding tax requirement.
- When the tips were included and paid by a customer's credit card, such tip went into the employer's account, after which it was distributed to the employees; the receipt of such money from the employer would amount to salary.

Held

The SC, while ruling in favour of the taxpayer and setting aside the Delhi HC's judgment, held that since the contract of employment in the present case was not the proximate cause for the receipt of tips by the employees from the customers, the same would be outside the salary taxation provisions of the Act. Thus, there would be no obligation on the employer to withhold tax under section 192 of the Act while making such payments to the employees.

The SC elaborated as follows:

- Under section 192 of the Act, the person responsible for paying salaries alone was responsible for withholding tax, and such person was only the employer; however, on the given facts, the person responsible for paying the employees was not the employer at all, but a third person, namely the customer.
- The income from tips would be chargeable in the hands of the employees as income from other sources, and not as income from salary; if an employee received payment other than salary income, section 192 did not apply.
- For salary taxation provisions of the Act to apply, an employee should have a vested right to claim salary from an employer. Since, in the given facts, the employee had no vested right to claim any amount of tip from his employer, tips being purely voluntary amounts from customers, they would not fall within 'salary income' under the Act.
- Salary taxation provisions of the Act necessarily referred to the contract of employment between employer and employee, and salary paid or allowed must therefore have reference to such contract of employment. In the given case, tips paid over by the employer to employees had no reference to the contract of employment.

- Tips would not be payments made "by or on behalf of" an employer as these were never the property of the employer. In these circumstances, payments would be outside the purview of salary taxation provisions of the Act.

The SC has discussed the English judgment in the matter of Hochstrasser (Inspector of Taxes) *v.* Mayes, [1960] A.C. 376, which dealt with provisions (Para 2 of Schedule E of the English Income Tax Act, 1918) somewhat close to salary taxation provisions (section 15) of the Act. In that judgment, the House of Lords held that "*it is not enough for the Crown to establish that the employee would not have received the sum on which tax is claimed had he not been an employee at all. The Court must be satisfied that the service agreement was the* **causa causans** *and not merely the* **causa sine qua non** *of the receipt of the amount.*" The SC held that the same test of proximity with the service agreement which was applied by the House of Lords in that case was also applicable to the facts of the present case.

The Revenue's argument that the receipts of tips had indirect reference to the contract of employment was rejected by noting that such payments had no reference to the contract of employment, and were received from the customer, the employer being a conduit in a fiduciary capacity between the two.

The Revenue's argument that employees received payments from their employer, and that salary taxation provisions of the Act would apply, was also rejected by observing that under the scheme of such provisions, payment must be made by an "employer," a word that necessarily brought in a contract of employment, express or implied. While analysing different words used in sub-clauses of the relevant salary taxation provision [section 17(3)], it commented that the word "person" in one of the sub-clauses referred to a future or past employer; therefore, under the scheme of this provision, payment must be made by an employer, and the "employer" necessarily brought in a contract of employment.

The Revenue's argument that the expression "allowed" in salary taxation provisions was wide enough to include amounts such as tips paid by the employer to their employees, was also rejected by emphasising that the reference to the contract of employment must be established.

Editor's note

To render a payment assessable under the head "salary," it is not enough for Revenue to contend that the relationship between the payer and payee is that of employer and employee, and that the employee would not have received the sum had he not been an employee. It must also be established that the payment is "for services to the employer," and it must be sufficiently related to the "employment contract." Furthermore, the principle is reinforced that the benefit from the employer should be vested in the employee for it to become chargeable as the employee's salary income.

Capital gains

Income arising to non-resident from transfer of intangible property to another non-resident not taxable in India

WP(C) 6902/ 20z08 (Delhi)

*In the absence of any contrary local legislation, the well-accepted principle of "*mobilia sequuntur personam*" must be followed while determining the situs of intangible asset. Consequently, transfer from a non-resident to non-resident of intangible asset licensed to a person in India by the non-resident could not be held to be transfer of capital asset situated in India. Consideration in respect of such transfer, accordingly, was not taxable in India under the Act.*

Facts

The taxpayer had been in the business of brewing, processing, packaging, marketing, promoting and selling of beer products in Australia and abroad. It owned various brands, including the taxpayer's brand in relation to beer products. The taxpayer had been holding certificates of registration of trademarks, and had been continuously using the brand since its registration. In India, the taxpayer had registered its trademark and logo in July 1993. It had entered into a Brand License (BL) agreement in October 1997 with A India, granting a brewing license to A India. In addition, it had also granted A India an exclusive right to use the trademarks in the territory of India in relation to "ABC." It had been paying taxes under the Indian income tax law for royalty amounts received from A India. The taxpayer, in 2006, entered into a composite Sale and Purchase Agreement (ISPA) with C Limited, UK (C UK) for sale

of shares and sale by the taxpayer of the trademark and Brand Intellectual Property (IP) and to license the Brewing IP to C Limited, confined to the territory of India. The consolidated consideration payable for the above was US$120 million. In terms of the ISPA, C UK made a Deed of Assignment in favour of its Indian subsidiary, D Limited, nominating it as the transferee in terms of the ISPA, following which the taxpayer granted to D Limited an exclusive, perpetual and irrevocable license relating to the its Brewing IP. Additionally, the BL agreement entered into between the taxpayer and A India had been terminated. Subsequently, the intangible property had reverted to the taxpayer. The above events happened simultaneously.

The taxpayer made an application to the AAR regarding the taxability of consideration arising on the transfer of its right, title and interest in and to the Trademark and Brand IP and grant of exclusive perpetual license of the Brewing IP. The AAR held that there was no legal principle that the *situs* of intangible assets such as trademark and goodwill would always go with ownership, and intangible assets would have no *situs* other than the country of fiscal residence of the owner.

The AAR also held that the trademarks registered in India, along with the other features of the brand, had undoubtedly generated appreciable goodwill in the Indian market, and such goodwill had been nurtured in India by the reason of coordinated efforts of the taxpayer and A India. Therefore, the AAR concluded that the intellectual property belonging to the taxpayer had its "tangible presence" in India at the time of the transfer. Accordingly, the AAR ruled that the capital asset transferred by and through the ISPA read with Deed of Assignment were "situated in India" in terms of section 9(1)(i) of the Act.

The taxpayer filed a Special Leave Petition before the SC, which was withdrawn later, and an appeal filed before the Delhi HC.

Held

The HC observed that the issue of *situs* of an intangible asset was a tricky issue as opposed to that of tangible assets that had a physical presence in India. The legislature could have, through a deeming fiction, provided for the location of an intangible capital asset, such as intellectual property rights, but it has not done so insofar as India was concerned. With regard to a share or interest in a company registered/ incorporated outside India, Explanation 5 has been added to section 9(1)(i) of the Act by virtue of the Finance Act, 2012 with retrospective effect from 1 April, 1962 to provide that the *situs* of the said share or interest would be in India. There was no such provision with regard to intangible assets, such as trademarks, brands, logos, i.e., intellectual property rights. Therefore, the well-accepted principle of "*mobilia sequuntur personam*" would have to be followed. The *situs* of the owner of an intangible asset would be the closest approximation of the *situs* of an intangible asset. This was an internationally accepted rule, unless it was altered by local legislation. As noted above, there was nothing in the Indian laws providing for the same. The HC therefore held that the income accruing to the taxpayer from transfer of its right, title or interest in and to the trademarks in A's brand intellectual property was not taxable in India under the Act.

Editor's note

The HC's overruling of the AAR on the above issue is a relief in the context of cross-border acquisition transactions that involved transfer of intangible property used in India by Indian affiliates of multinational companies.

Loan waiver

Loan waiver a taxable benefit/ perquisite; absence of "the" before "business" influences section 28(iv) interpretation

CIT *v.* Ramaiyam Homes (P) Limited [2016] 68 taxmann.com 289 (Madras)

Waiver of principal portion of loan taken to acquire a capital asset is covered within the purview of section 28(iv) of the Act, and hence taxable as revenue receipt.

Facts

The taxpayer had taken a loan from a bank for acquiring a capital asset. The loan outstanding was waived by the bank as a part of a one-time settlement. The taxpayer treated the waiver of both, principal and interest, as capital receipt and excluded the same while computing its taxable income. The TO treated the interest waived by the bank as income under section 41(1) of the Act and the principal amount as income under section 28(iv) of the Act. While disposing off the taxpayer's appeal, the CIT(A) partially upheld the TO's order and upheld the disallowance of interest portion waived off as taxable income

under section 41(1) of the Act. On the issue of taxability of the principal waived, the CIT(A) followed the decision of Iskraemeco Regent Limited *v.* CIT [2011] 196 Taxman 103 (Madras) and held that section 28(iv) of the Act had no application to cases involving waiver of principal amounts of loans. The Tribunal confirmed the CIT(A)'s order.

Held

On the question of taxability of waiver of principal portion of term loan, the HC held that the same should have been taxable under section 28(iv) of the Act. In addition, the HC rejected the Tribunal's and CIT (A)'s reliance on the co-ordinate bench ruling in Iskraemeco Regent Limited (*supra*). The HC differed from the reasoning given in the co-ordinate bench ruling that section 28(iv) of the Act dealt only with a benefit or perquisite received in kind, and not with any transaction involving money. The HC also remarked that the Delhi HC had not taken note of the above-mentioned fallacy while deciding the issue in the case of Logitronics Private Limited *v.* CIT [2011] 333 ITR 386 (Delhi) as well as Rollatainers Limited *v.* CIT [2011] 339 ITR 54 (Delhi). Waiver of a portion of the loan would tantamount to a benefit. The HC had dissected the language used in section 28(iv) to hold that the benefit may not arise from "the business" of the taxpayer, but it certainly arose from "business." The HC had also given weightage to the absence of the prefix "the" to the word "business" while deciding the issue. It categorically held that the absence of the prefix "the" to the word "business" made a significant difference. While differing from the co-ordinate bench ruling, the HC also observed that there was no distinction between the waiver of loan taken for acquiring a capital asset and waiver of loan taken for trading activities in accounting practice, and that such waiver would either be credited to profit and loss account or to the capital reserve.

Editor's note

The HC has rejected the argument that use of borrowed funds for capital purposes or revenue purposes would determine the taxability of the waiver. It has emphasised more on accounting entries and has not dealt with the aspect of taxability vis-à-vis *nature of loan in detail. The Madras HC has imparted a different dimension to a settled law, and as the decision in the case of Iskraemeco Regent Limited* (supra) *is sub judice before the SC, taxpayers will have to wait till the SC decides the matter for finality on this issue.*

Tax refund

Income-tax refund is a "debt claim" due from the Government and interest thereon exempt under Article 12(3) of the India-Italy tax treaty

Tax Case Appeal No. 19 to 21 of 2016 (Madras)

Income-tax refund was a "debt claim"; hence, the interest paid thereon was covered by the definition of "interest" provided under Article 12(4) of the India-Italy tax treaty. The interest on income-tax refund, being a payment made by the Government of the Contracting State (i.e., India in this case), was exempt from tax in India as per Article 12(3)(a) of the tax treaty.

Facts

The taxpayer was a company incorporated under the laws of Italy and a resident of Italy for the purposes of the tax treaty. The taxpayer was engaged in the business of designing, building and supplying full range of plant solutions on different types of packages such as turnkey, engineering and individual components worldwide, and was a global power generation player and covered the entire power generation spectrum. The TO passed orders giving effect to the orders of the Tribunal and CIT(A), determining a refund payable to the taxpayer. The TO also granted interest under section 244A of the Act. While making payment of the interest along with income-tax refund, the TO withheld tax at the full rate of 42.024%. On appeal to the first appellate authority, the CIT dismissed the taxpayer's appeals. Before the Tribunal, the taxpayer relied on various decisions. On the basis of the decisions, the taxpayer contended that income-tax refund due and payable to the taxpayer was a debt owed and payable by the Revenue, and such interest on income-tax refund was not effectively connected with a PE on the basis of either the asset test or the activity test. Consequently, the taxpayer contended that the interest was not taxable in India under Article 12(3) of the tax treaty. The Revenue relied on the Delhi Tribunal ruling in the case of BJ Services Company Middle East Limited *v.* ACIT [2009] 29 SOT 312 (Delhi), wherein, relying on the provisions of Article

12(6) of the India-UK tax treaty, the Tribunal had held that as the interest on income-tax refund was effectively connected to the PE of the taxpayer, the interest income was taxable as business income under Article 7 of the India-UK tax treaty. The Tribunal rejected the taxpayer's contention and held that interest on income-tax refund was not envisaged in the definition of "interest" as per Article 12(4) of the tax treaty. Accordingly, the Tribunal held that the lower authorities were justified in withholding tax at 42.024%.

Held

The HC observed that as per section 244A, a taxpayer was entitled to receive simple interest in addition to any amount of refund that had become due to him. Two important expressions, namely, "becomes due" and "be entitled to" were used in this section. The expression "becomes due" was a clear indication that a taxpayer would be entitled to the benefit of section 244A only if the refund of any amount had become due. If a refund had become due, interest thereon was also automatic, subject to the satisfaction of other conditions. Anything that was due and which a person was entitled to collect, was naturally in the nature of a debt claim. Consequently, interest payable on such refund (i.e., debt claim) would be covered by the definition of "interest" in Article 12(4) of the tax treaty, and consequently, in view of Article 12(3)(a) of India-Italy tax treaty, the same would exempt from tax in India. The HC also rejected the Revenue's contentions in relation to the SC decision and held that the SC's observation i.e., *"refund due and payable to the taxpayer is a debt owed and payable by the Revenue,"* was actually a perfect statement of law. The HC also rejected the Revenue's reliance on Article 12(6) and observed that the exemption provided under Article 12(3)(a) of the tax treaty was not impacted by Article 12(6) as, in the present case, the Government was the payer.

Editor's note

The HC has affirmed the principle that refund of income-tax is a debt claim payable by the Government and interest thereon would be governed by the provisions of Article 12 (Interest) which specifically deals with interest income. This HC decision should help in bringing certainty to taxpayers who are litigating this issue before tax authorities.

Having said the above, the HC has not discussed the impact of Article 12(5) of the tax treaty, wherein it is clarified that the taxability of interest will be governed by the laws of India, if the interest arises in India through a PE of the taxpayer in India and if the relevant debt claim is effectively connected to such PE of the taxpayer.

Withholding tax

No tax to be withheld on commission paid to non-resident agent even in cases where orders ultimately secured from an Indian company

Accurate Engineering Co. Limited *v.* DCIT [ITA No. 620/ PN/ 2014 (Pune-Tribunal)]

Tax was not required to be withheld under section 195 of the Act on commission payment to foreign agents for securing orders from an Indian subsidiary of an Italian company. The Tribunal rejected the Revenue's contention that since orders were secured from an Indian entity, services had to be deemed to have been provided in India.

Facts

The taxpayer was engaged in the business of manufacture of precision measuring, checking instruments and gauges used to control quality of engineering production. It had paid commission without withholding taxes to an agent based in Italy for securing purchase orders from an Indian subsidiary of an Italian company. The taxpayer had appointed the agent to follow-up with the Italian company due to distance and language barriers. The foreign agent was instrumental in procuring orders for the taxpayer, and was involved in pre-order and post-order follow-up and liaison with the Italian entity.

The TO disallowed the commission expense during regular assessment proceedings under section 40(a)(i) of the Act as no tax had been withheld.

Held

The Tribunal observed that it was an undisputed fact that services rendered were neither technical nor managerial in nature. It also observed that the Revenue was unable to show that the foreign agent had a PE in India. It held that as the foreign agent was involved

in liaison/ following up with the Italian company, the services were rendered outside India. The Tribunal further distinguished the Delhi HC decision in the case of CIT *v.* Havells India Limited [2012] 21 taxmann.com 476 (Delhi) on facts, as in that case, the taxpayer had paid fees for testing and certification services. The Tribunal discussed the CBDT Circular No. 786 dated 07 February, 2000 that clarified the taxability of export commission payable to non-resident agent for rendering services abroad, and held that no tax needed to be withheld under section 195 on such export commission. Referring to a judicial precedent relied upon by the taxpayer, *viz.*, CIT *v.* Faizan Shoes Private Limited [2014] 367 ITR 155 (Madras), the Tribunal held that payment of commission to a foreign agent was not liable to tax in India. In this case, the Madras HC had also held that services rendered by an agent were not covered under the category of FTS. It further placed reliance on the SC's ruling in the case of GE India Technology Centre *v.* CIT [2010] 327 ITR 456 (SC), to hold that tax was required to be withheld only if such sum was chargeable to tax under the Act. Accordingly, the Tribunal concluded that the taxpayer was not required to withhold tax on commission paid to foreign agent, as the services were rendered outside India and hence disallowance under section 40(a)(i) of the Act would not sustain.

Editor's note

While there are many rulings in cases of payment of commission to non-resident agents for export sales, the Tribunal has gone a step further and held that tax was not applicable in case services were rendered outside India, even though ultimately, the orders were being secured from an Indian company. Since this case pertains to payment made before the withdrawal of CBDT Circular No. 786, the position post the withdrawal has not been specifically discussed by the Tribunal. Hence, its applicability after withdrawal of circular needs to be evaluated. This ruling is a welcome ruling for taxpayers who are engaged in litigation on a similar issue.

Notifications and circulars

Place of Effective Management (PoEM)

CBDT issues draft guidelines for determination of PoEM

Press Release F. No. 142/ 11/ 2015-TPL dated 23 December 2015

The CBDT has issued draft guidelines for the determination of the PoEM of a company. In brief, the guidelines state the following:

- Process and guidance for determination of PoEM of companies—both that are engaged in active business outside India and those that are not.
- Factors, which by itself would not lead to a conclusion that PoEM of a company is situated in India.
- Process to be followed by a TO if he finds that a company incorporated outside India is resident in India due to its PoEM being in India.

Precursor

The Finance Act, 2015 amended the residency test for companies, whereby a company would be regarded as resident in India, if it was an Indian company or if the PoEM of the company was in India during the relevant year. PoEM was defined as "a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made." The Explanatory Memorandum to the Finance Act, 2015 mentioned that the CBDT would issue guidelines for the determination of PoEM, for the benefit of taxpayers and the tax administration. Accordingly, the CBDT issued draft guidelines for the determination of PoEM and had invited comments and suggestions on the guidelines from stakeholders before 02 January, 2016.

I. General guidance

- The process of determination of PoEM would generally be:
  - based on the facts and circumstances;
  - driven by the principle of substance over form;
  - based on the place where decisions are taken, rather than the place where decisions are implemented.
- Day-to-day routine operational decisions shall not be relevant for the determination of PoEM.

II. Guidance for companies engaged in active business outside India

A company would be regarded as engaged in an active business outside India if the passive income of the company does not exceed 50 percent of its total income and:

- less than 50 percent of its total assets are situated in India; and
- less than 50 percent of the total number of employees are situated in India, or are resident in India; and
- the payroll expenses incurred on such employees is less than 50 percent of its payroll expenditure.

Passive income of a company is defined as the aggregate of:

- income from transactions where both purchase and sale of goods is from/ to its associated enterprises; and
- income by way of royalty, dividend, capital gains, interest or rental income.

For the above test, the average of the data of the current year and two years prior to that shall be considered. If the company has been in existence for a shorter period, then the data of such period shall be considered.

For a company engaged in active business outside India, its PoEM will be presumed to be outside India if the majority of the meetings of the board of directors of the company are held outside India. However, if it is established that the board of directors are not exercising their powers of management, and such powers are being exercised by either the holding company or any other person resident in India, then the company's PoEM shall be considered to be in India.

III. Guidance for companies not engaged in active business outside India

For companies not engaged in active business outside India, a two-stage process for determination of their PoEM has been specified as follows:

- Identifying or ascertaining the person or persons who actually make the key management and commercial decisions for the conduct of the company's business as a whole.
- Determination of the place where these decisions are being taken.

The following guiding principles are provided in this context, none of which would be decisive by themselves, but will have to be considered in a holistic manner:

Location of meeting of company's board

The place where the company's board regularly meets and makes decisions can be considered as the PoEM, provided the company's board:

- retains and exercises its authority to govern the company; and
- does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.

If the key decisions by the directors are being made in a place other than the place where the formal meetings are being held, then such other place would be relevant for determination of PoEM.

If the board has *de facto* delegated the authority to make key management and commercial decisions for the company to the Senior Management or to any other person, including a shareholder, and does nothing more than ratifying such decisions, then the PoEM would be the place where such Senior Management or other persons make those decisions. The term Senior Management has been defined, and it includes key managerial personnel such as Managing Director or CEO and the heads of various divisions or departments such as Sales or Marketing.

Executive Committee

If the company's board has delegated (*de jure* or *de facto*) some or all authority to an executive committee consisting of members of Senior Management, the location where the members of such committee are based and where that committee develops and formulates the key strategies and policies for approval of the board, will be considered as the PoEM.

Location of head office of company

The company's head office would be a very important factor in the determination of the company's PoEM. The Head office of a company has been defined as "*The place where the company's senior management and their direct support staff are located or, if they are located at more than one location, the place*

where they are primarily or predominantly located. A company's head office is not necessarily the same as the place where the majority of its employees work or where its board typically meets."

In this connection, the following points have been provided for determining the location of the head office of the company:

If due to use of modern technology, it is determined that the physical location of board meeting or executive committee meeting may not be where the key decisions are in substance made, then the place where directors or persons taking decisions or majority of them usually reside may also be a relevant factor.

Situation	Head office location
Company's Senior Management and their support staff are based in a single location that is held out to the public as company's principal place of business or headquarters.	Such principal place of business or headquarters.
Company is more decentralised, and hence Senior Management operates from time to time at offices in various countries.	Location where these senior managers: • are primarily or predominantly based; or • normally return to following travel to other locations; or • meet when formulating or deciding key strategies and policies for the company as a whole.
Members of Senior Management operate from different locations on a more or less permanent basis and members participate in various meetings **via** telephone/ video conference	Location, if any, where the highest level of management (e.g.: Managing Director and Financial Director) and their direct support staff is located
Where the Senior Manager is so decentralised that it is not possible to determine the company's head office with a reasonable certainty	Location of the head office would not be much relevant in determining PoEM

Secondary factors

If the above factors do not lead to a clear identification of the PoEM, then the following secondary factors can be considered:

- Place where main and substantial activity of the company is carried out; or
- Place where accounting records of the company are kept.

IV. Factors that do not by itself establish PoEM

Determination of PoEM is to be based on all relevant facts related to management and control of a company, and not on the basis of isolated facts that do not establish effective management, as illustrated below:

- A foreign company is completely owned by an Indian company
- One or some of the Directors of a foreign company reside in India
- Local management being situated in India in respect of activities carried out by a foreign company in India
- The existence in India of support functions that are preparatory and auxiliary in character

V. Other points

The above principles are for guidance, and no single principle will be decisive in itself.

The principles have to be seen with reference to activities performed over a period of time and no "snapshot" approach is to be adopted.

If, based on facts and circumstances, it is determined that during the previous year, the PoEM is in India and also outside India, then the PoEM shall be presumed to be in India if it has been mainly/ predominantly in India.

A TO can hold a company incorporated outside India, on the basis of its PoEM, as being resident in India only after seeking prior approval of the Principal Commissioner or the Commissioner, as the case may be, in this regard. The Principal Commissioner or the Commissioner shall provide an opportunity of being heard to the company before deciding the matter.

Editor's note

These guidelines have been long awaited, and hence, the introduction of draft guidelines with a view to seek comments from the stakeholders is a welcome step. The draft guidelines lay down certain principles, which can be considered to determine the PoEM of a company. As determining the PoEM depends on facts and circumstances, the principles will necessarily involve a holistic factual analysis and should not be applied in an isolated manner. Lastly, the principles do serve as a good basis for the determination of PoEM by the authorities. Further, they provide clarity to taxpayers regarding the factors that would be considered by the tax administration in determining PoEM. It is important for the industry to provide appropriate inputs to the CBDT, based on practical considerations involved in the management of companies, particularly joint ventures.

Payments to non-residents

CBDT amends rules for furnishing information regarding payments to non-residents

Notification No. 93/ 2015 [F. No. 133/ 41/ 2015-TPL]/ G.S.R 978 (E) dated 16 December 2015

Rule 37BB of the Rules prescribes the information required to be furnished by a remitter while making a payment to a non-resident recipient. The Finance Act, 2015 amended section 195(6) of the Act read with Rule 37BB, to provide that the remitter paying any sum, regardless of whether it is chargeable under the provisions of the Act, shall furnish the information relating to the payment in a form and manner as prescribed by the CBDT. Further to the amendment by the Finance Act, 2015, the CBDT has amended Rule 37BB to prescribe the form and manner of furnishing the information regarding such remittances to a non-resident, not being a company, or to a foreign company (recipient) electronically. The new Rule 37BB will come into effect from 01 April, 2016.

Background

Previously, the Rule required the remitter to electronically furnish a self-declaration in Form 15CA while making payment based on a certificate from a Chartered Accountant in Form 15CB. The remitter was obliged to provide information to the tax authorities with regard to payments that were chargeable to tax. To identify all payments to non-residents on which there was a failure to withhold tax, and to make sure that tax was withheld at the appropriate rate, an amendment to section 195(6) of the Act was introduced *via* the Finance Act, 2015. This amendment extended the reporting requirement to any payment made to a non-resident, regardless of whether it is chargeable to tax in India.

The key features of the new Rule 37BB are as follows:

- The remitter shall furnish the following information while remitting to a non-resident recipient any sum chargeable under the Act–
  - Information in Part A of Form 15CA, if the payment, or the aggregate of such payments, during the FY, does not exceed INR0.5 million;
  - Where the payment or the aggregate of such payments during the FY exceeds INR0.5 million, information –

    (a) In Part B of Form 15 CA after obtaining –

    i) A certificate from the TO for deduction at a lower rate (section 197 of the Act); or

    ii) An order from the TO where entire sum is not income chargeable, or in case of any person entitled to receive any

interest or other sum in which income-tax has to be deducted (subsections (2) or (3) of section 195 of the Act);

(b) In Part C of Form 15 CA, after obtaining a CA certificate in Form 15CB.

- If the remittance is of any sum that is not chargeable under the Act, the remitter shall furnish the information in Part D of Form 15CA.
- Besides the above, no information is required to be furnished for any sum that is not chargeable under the provisions of the Act if –
  - remitted by an individual, and does not require RBI approval as per section 5 of the Foreign Exchange Management Act, 1999 read with Schedule III to the Foreign Exchange (Current Account Transaction) Rules, 2000; or
  - in case of specified remittances (33 such remittances have been specified).
- The information in Form 15CA shall be furnished electronically under digital signature in accordance with the procedures, formats and standards specified by the Principal Director General of Income-tax (Systems), and thereafter, either a printout or a signed printout of the form shall be submitted to the authorised dealer prior to the remittance.
- The authorised dealer may be required to furnish the signed printout of Form 15CA to an income-tax authority for the purposes of any proceedings under the Act.
- The certificate in Form 15CB shall be furnished and verified electronically in accordance with the procedures, formats and standards specified by the Principal Director General of Income-tax (Systems).
- The authorised dealer shall furnish a quarterly statement for each quarter of the FY in Form 15CC to the Principal Director General of Income-tax (Systems), or to the person authorised by him, electronically under digital signature within 15 days from the end of the quarter of the FY to which such statement relates, in accordance with the specified procedures, formats and standards.
- The Principal Director General of Income-tax (Systems) shall specify the procedures, formats and standards for furnishing and verification of Form 15CA, Form 15CB and Form 15CC, and shall be responsible for the day-to-day administration in relation to such furnishing and verification of information, certificates and quarterly statement.

"Authorised dealer" refers to a person authorised to act as an authorised dealer under subsection (1) of section 10 of the Foreign Exchange Management Act, 1999. To access the amended Forms, please click here.

Editor's note

This represents another way in which the tax department is seeking to obtain information on non-deduction of tax at source, or deduction of tax at lower rates, from payments made to non-resident recipients.

Treaty benefit

Benefit of India-UK tax treaty to UK Partnerships clarified

Circular No. 2/ 2016 dated 25 February, 2016

In the light of the amended protocol to the India-UK tax treaty (notified in February 2014), the CBDT has clarified that the benefits of the India-UK tax treaty would be applicable to a partnership, estate or trust that is a resident of India or UK. The benefits, however, will be limited to the extent that the income derived by such partnership, estate or trust is subject to tax in that State as the income of a resident, either in its own hands or in the hands of its partners or beneficiaries.

An amending protocol to the India-UK tax treaty was notified in February 2014 with effect from 27 December, 2013. As per the protocol, the definition of the term "person" was amended to remove the exclusion for partnerships. Further, the term "resident" was amended to include partnerships, estate or trusts as resident of a Contracting State to the extent the income of such partnership, estate or trust is subject to tax in the Contracting State as the income of a resident, either in its hands or in the hands of partners or beneficiaries. The CBDT has acknowledged that even after the amended protocol, there have been apprehensions that the term "person" does not specifically include

partnerships. Accordingly, further clarity had been sought from the CBDT on whether the provisions of the India-UK tax treaty were applicable to a partnership. The CBDT has accordingly clarified that the provisions of the India-UK tax treaty would be applicable to a partnership that is a resident of either India or UK, to the extent that the income derived by such partnership, estate or trust is subject to tax in that State as the income of a resident, either in its own hands or in the hands of its partners or beneficiaries.

Editor's note

Whether a UK partnership has access to the India-UK tax treaty has been a subject matter of debate and litigation in Indian courts. The debate has existed since the definition of the term "person" under the India-UK tax treaty excluded UK partnerships as such partnerships are considered as fiscally transparent entities under the UK laws.

Although the Courts in the case of Linklaters LLP v. ITO [2010] 40 SOT 51 (Mumbai-Tribunal) and P&O Nedlloyd Limited v. ADIT [2014] 52 taxmann.com 468 (Calcutta) did grant benefit to the UK partnerships, the TOs at the time of assessment continued to disallow the benefits to UK partnerships. Accordingly, the CBDT Circular, which is binding on tax authorities, will help provide certainty.

Equalisation levy

CBDT notifies Equalisation Levy Rules, 2016

Notification No. 38/ 2016 F.No. 370142/ 12/ 2016-TPL SO 1905 (E) dated 27 May, 2016

Background

In line with the OECD BEPS project to tax e-commerce transactions, the Finance Act 2016, had inserted a separate Chapter VIII titled "Equalisation Levy." The newly inserted provisions of the Act provide for an equalisation levy of 6% to be deducted from amounts paid to a non-resident not having any PE in India, for specified services (*'Specified service' means online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement and includes any other service as may be notified by the Central Government*).

The CBDT recently issued a notification stating that the provisions of Chapter VIII relating to the equalisation levy would come into effect from 01 June, 2016. In other words, any payments being made for the specified services provided on or after 01 June, 2016 shall attract the equalisation levy.

Notified rules

The CDBT has also notified the Equalisation Levy Rules, 2016 (Rules), which lays down the procedural framework for the compliances to be undertaken, and the appeals process to be followed for such levy. These Rules would also be effective from 01 June, 2016.

The summary of the Rules is as follows:

Particulars	Section No. (of Finance Act 2016)	Rule No. (of Equalisation Levy Rules, 2016)	Description
Computation and payment of equalisation levy	Section 166	Rule 3 and Rule 4	The amount of consideration of specified services, equalisation levy, interest and penalty payable shall be rounded off to the nearest multiple of ten rupees. Equalisation levy deducted during any calendar month is to be paid to the credit of the Central Government by remitting it to the Reserve Bank of India or the State Bank of India or any other authorised bank, accompanied by an equalisation levy challan by the seventh day of the month immediately following the calendar month.
Furnishing of statement of specified services/ annual return	Section 167	Rule 5 and Rule 6	The statement of specified service is required to be furnished electronically in Form No. 1 (verified through either a digital signature or an electronic verification code by an authorised signatory) on or before 30 June immediately following that financial year. The TO has been empowered to issue notice for furnishing such statement, which then has to be furnished within 30 days from date of serving of such notice, where the same is not filed within the prescribed timeline.
Processing of statement of specified services	Section 168	Rule 7	Where any levy, interest or penalty is payable under the equalisation levy provisions, a notice of demand specified in Form No. 2 shall be served upon the taxpayer. Further, intimation issued upon processing of the statement of specified services shall also be deemed to be a notice of demand.
Filing of appeal against the penalty order before the CIT(A)	Section 174	Rule 8	An appeal against the penalty order shall be electronically filed before the CIT(A) in the prescribed Form No. 3 (verified through either a digital signature or an electronic verification code by the person authorised to verify the statement of specified services), within thirty (30) days of receipt of the penalty order. Further, a sum of INR1,000 is required to be deposited as appeal filing fee.
Filing of appeal before the Tribunal	Section 175	Rule 9	An appeal against the order of the CIT(A) has to be filed in triplicate with the Tribunal within sixty (60) days of date of receipt of the order of CIT(A) in the prescribed Form No. 4. Further, a sum of INR1,000 is required to be deposited as appeal filing fee.

Editor's note

The rules relating to deduction and payment of equalisation levy and filing of appeals, including the prescribed forms, are similar to those prescribed under the Income-tax Rules, 1962. One may also expect further clarifications regarding the forms for payment of equalisation levy and procedural guidance for electronic processing of the prescribed statement of specified services.

Dispute resolution

Government notifies the Direct Tax Dispute Resolution Scheme Rules, 2016

Notification No. 35/ 2016 F.No. 142/ 11/ 2016-TPL SO 1903 (E) dated 26 May 2016

The Finance Act, 2016 introduced the Direct Tax Dispute Resolution Scheme (the Scheme) that provides an opportunity to taxpayers to settle their past cases by making payment of the prescribed tax, interest or penalty in respect of any tax arrears or specified tax.

The Scheme is incorporated as Chapter X of the Finance Act, 2016 comprising of sections 200 to 211. The Scheme is applicable from 01 June, 2016. The Central Government has notified the Direct Tax Dispute Resolution Scheme Rules, 2016 (the Rules) for carrying out the provisions of the Scheme. The Central Government, *vide* a separate Notification dated 26 May, 2016, has notified 31 December, 2016 as the date on or before which a person may make a declaration to the designated authority under the Scheme.

The Rules prescribe the specific Forms to be used for carrying out the provisions of the Scheme. The table below summaries the various Forms:

Form No.	Particulars	Time line	Contents of the Form
Form-1	Form of declaration to be made by the declarant in respect of "tax arrear" and "specified tax"	Declaration can be made on or after 01 June, 2016, and upto 31 December, 2016	**General information** Details of the declarant, i.e., name, address, PAN, legal status, tax residential status, etc. **In respect of tax arrears** Details of appeals pending before CIT(A)/ CWT(A) as on 29 February, 2016 • Details of assessment order and/ or penalty order, as the case may be (**viz.,** assessed total income, tax, interest, penalty, etc.). **In respect of specified tax** • Details of appeal/ writ filed or proceedings for arbitration/ conciliation/ mediation initiated or notice given, which are pending as on 29 February, 2016. • Details of assessment order (**viz.** assessed total income, tax, interest, etc.). **Other points** To be signed by the declarant or any person competent to verify the return of income on his behalf in accordance with section 140 of the Act.

Form No.	Particulars	Time line	Contents of the Form
Form-2	Undertaking to be filed by the declarant in respect of "specified tax"	To be furnished along with Form-1	Undertaking to voluntarily waive all rights in respect of specified tax, whether direct or indirect, to seek or pursue any remedy or any claim in relation to specified tax.
Form-3	Certificate of intimation to be issued by the designated authority	To be issued within 60 days from date of receipt of the declaration in Form-1	• Amount payable by the declarant (AY-wise) towards full and final settlement of the tax arrear/ specified tax. • Direction to the declarant to make payment of the amount within 30 days from the date of receipt of this certificate, failing which the declaration shall be treated as void.
Form-4	Intimation of payment to be filed by declaration	To be filed within 30 days of the date of receipt of certificate in Form-3	Details of challan evidencing amount paid by the declarant.
Forms-5 and 6	Order to be passed by the designated authority for full and final settlement of "tax arrears" (Form-5) and "specified tax" (Form-6)	No time limit specified	Order certifying the tax settlement and granting immunity from instituting any proceeding for prosecution for any offence or from the imposition of penalty under the Act/ Wealth-tax Act, in respect of the disputed tax/ disputed income.

Editor's note

The Scheme introduced in the Finance Act, 2016 could facilitate settlement of pending direct tax litigation.

Grandfathering investments

GAAR – grandfathering of investments made prior to 1 April, 2017

Notification No. 49/ 2016 F. No. 370142/ 10/ 2016-TPL dated 22 June 2016

In the Memorandum explaining the provisions of the Finance Bill 2015, it had been stated that investments made prior to 01 April, 2017 are proposed to be protected from the applicability of GAAR by amending the relevant rules in this regard.

The CBDT has amended Rule 10U of the Rules to the following effect:

- The provisions of Chapter X-A (dealing with GAAR) shall not apply to any income accruing or arising to or deemed to accrue or arise to or received or deemed to be received by any person from transfer of investments made before 01 April, 2017;
- Without prejudice to the above, the provisions of Chapter X-A shall apply to any arrangement, irrespective of the date on which it has been entered into, in respect of tax benefit obtained from the arrangement on or after 01 April, 2017.

Editor's note

Only income from transfer of investments made prior to 01 April, 2017 has been grandfathered. It should allay some of the concerns with respect to implementation of GAAR provisions, and provide certainty to taxpayers.

Foreign tax credit

CBDT notifies FTC Rules allowing resident taxpayers to claim credit for taxes paid overseas

Notification No. 54/ 2016 F.No. 142/ 24/ 2015-TPL SO 2213 (E) dated 27 June, 2016

After considering the comments and suggestions from the public on the draft rules, the CBDT has notified Rule 128. The Rules lay down broad principles and conditions for computation and claim of foreign taxes paid in overseas countries by resident taxpayers. These Rules will come into effect from 01 April, 2017.

The Rules are summarised below:

Particulars	Details
Meaning of foreign tax	In respect of a country with which India has entered into a double taxation avoidance agreement (tax treaty) - taxes covered under that tax treaty. In respect of any other country - the tax payable under the law in force in that country in the nature of income-tax.
Mode of payment of foreign tax	Direct payment of tax or by way of deduction.
Year of availability	• FTC shall be available to the taxpayer in the year in which the income corresponding to such foreign tax has been offered/ assessed to tax in India. • Where the income corresponding to foreign tax is offered to tax in more than one year, FTC shall be available across those years, in proportion to the income offered/ assessed to tax in India.
Tax against which FTC is available	• FTC shall be available against the amount of tax, surcharge and cess payable under the Act; • FTC shall also be allowed against tax payment under MAT/ AMT provisions.
Availability of credit of disputed foreign tax	Credit of disputed foreign tax shall be available for the year in which the corresponding income is offered to tax or assessed to tax in India, if the taxpayer furnishes the following evidence within six months from the end of the month in which disputed foreign tax is finally settled: • Evidence of settlement of dispute; • Evidence to the effect that the liability for payment of such foreign tax has been discharged by the taxpayer; and • An undertaking that no refund in respect of such amount has been directly/ indirectly claimed, or shall be claimed by the taxpayer.

Particulars	Details
Mode of computation	• Total available FTC shall be the aggregate of the amounts of FTC computed separately for each source of income arising from a particular country. • FTC shall be the lower of: – tax payable under the Act on such income; or – foreign tax paid on such income. Where the foreign tax paid exceeds the amount of tax payable under the provisions of tax treaty, such excess amount shall not be considered.
Rate of exchange for conversion of FTC	Telegraphic transfer buying rate (adopted by State Bank of India) on the last day of the month immediately preceding the month in which such tax has been paid or deducted.
MAT/ AMT credit to be carried forward	Any excess of FTC available against tax payable under the MAT/ AMT provisions as compared to the tax payable under the normal provisions shall be ignored while computing the MAT/ AMT credit.
Documents required in order to claim FTC	The taxpayers shall be required to furnish following documents on or before due date of filing of tax return under the Act: • A statement of foreign income offered to tax and the foreign tax deducted or paid on such income in Form No. 67; and • Certificate or statement specifying the nature of income and foreign tax deducted or paid: – From the tax authority of the foreign country; or – From the person responsible for deduction of such tax; or – Signed by the taxpayer accompanied by proof of tax payment and/ or proof of deduction.
Reporting in relation to refund of foreign taxes	Taxpayer is required to report, in Form 67, the refund of foreign taxes on account of carry-backward of current year losses in overseas country, if any, which have been availed as FTC in India.

Editor's note

In the absence of FTC rules, it was difficult for taxpayers and tax authorities to agree on credit claims. Relaxation of requirement of obtaining certificate from foreign tax authority, as provided for in the draft rules, indicates a practical approach to FTC claims in India. Certain other aspects relating to FTC, such as underlying tax credit on dividend income and branch profit tax, are not addressed in the rules.

Case law

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Financial Services

Case law

Land leasing

Upfront premium received for leasing of land on BOT basis taxable on receipt basis

Mangalore Port Trust *v.* ACIT [ITA No.1299/ Bang/ 2013 (Bangalore-Tribunal)]

Upfront premium received by taxpayer for leasing out port land to companies for 30 years on BOT basis was held to be taxable on receipt basis. The taxpayer's claim to spread taxability over the period of the lease was denied.

Facts

The taxpayer was a local authority carrying on the business of providing port facilities at New Mangalore Port, which included the docking of ships, loading and unloading, warehousing, etc. The taxpayer formulated a scheme of BOT under which the taxpayer permitted three companies to develop certain facilities on the land provided by the taxpayer. In terms of the concession agreement, the taxpayer received an upfront lump-sum premium. The companies were allowed to develop facilities and use the same for a period of 30 years. Apart from upfront premium, the concessionaires were also required to pay the taxpayer regular facilities charges (licence fees/ royalty) for handling cargo in designated port areas. In its return of income, the taxpayer offered 1/ 30th of the upfront premium as income and disclosed the balance amount as liability in the nature of pre-paid income. The TO treated the entire amount received from the companies as the taxpayer's income in the year of receipt/ entering into the concession agreement. The CIT(A) confirmed the additions made by the TO.

Held

The transaction of leasing out the land to the companies for 30 years was completed by executing the agreement. Thereafter, the taxpayer was not required to do or perform any act or obligation under the concession agreement. The taxpayer had received consideration for the grant of license/ lease to these three companies in lump-sum, apart from the annual license fee/ royalty, without any corresponding obligation to be discharged by the taxpayer. The upfront premium amount was admittedly a non-refundable amount, even if the concession agreement was terminated prematurely. As per the Profit and Loss Account, the taxpayer itself had recognised the entire upfront premium received as income for the year under consideration. This showed that the entire receipt had accrued during the year under consideration. Though the C&AG had raised some objections in his audit report in respect of recognising the entire income as income of the year under consideration, and recommended only a proportionate amount of upfront premium to be considered as income of the year under consideration, these remarks of the C&AG would not change the character or the incidence of accrual of the income. Thus, the taxpayer's claim was rejected, and the entire upfront premium received was treated as income for the current year.

Editor's note

The decision reiterates the important principle of accrual while determining taxable income. The tests laid down by the SC in the case of E.D. Sassoon & Co. Limited v. CIT [1954] 26 ITR 27 (SC) need to be performed while determining the accrual of the income. The treatment provided in the books of accounts may not be conclusive for determining the taxability of the income.

Treaty benefits

Pune Tribunal provides relief to a Singapore tax resident company, holding it to be the beneficial owner of royalty and interest and allowing treaty benefits even if remittance was made in a subsequent year

ITA No. 233/ PN/ 2014 (Pune-Tribunal)

The taxpayer was held to be a beneficial owner of the royalty and interest, and was also granted benefits of the tax treaty between India and Singapore even though the remittances were made in a subsequent year.

Facts

The taxpayer was a Singapore resident that rendered administrative, marketing and sales services to the group and affiliated companies trading in paper and performance minerals, and also undertook other related business activities, including project work. The taxpayer was a 100% subsidiary of A Co., and B Co. was its ultimate holding company. The taxpayer had entered into an agreement with C Limited, UK, to sub-license know-how to other group companies. As per the Technology License Agreement entered into

with D Private Limited, D Private Limited was granted a non-exclusive, non-transferable, non-assignable and revocable license to use the technology to manufacture, use and sell calcium carbonate and calcium products in the geographical territory of India. Further, another group company — E Private Limited — had obtained ECB loans from the taxpayer for purchase of capital goods, as it was in the process of setting up plants in India. The loans were granted in accordance with the ECB guidelines issued by the Reserve Bank of India. During the course of assessment proceedings, the taxpayer was asked to submit proof that it was the beneficial owner of interest and royalty and that the said incomes were remitted to, or received by, the taxpayer in Singapore and offered as income there. The TO noted that the beneficial owner of royalty was not the taxpayer, but C Limited, UK. The TO did not accept the taxpayer's claim that the know-how agreement with C Limited, UK, was on a principal-to-principal basis, and that the taxpayer was not its agent. As regards interest income, the TO observed that the taxpayer had failed to remit it in the same fiscal year. Thus, the TO rejected the taxpayer's claim for lower rate of tax for interest and royalty as per the tax treaty. In response, the taxpayer filed objections before the DRP, which confirmed the TO's decision; the benefits of the tax treaty to the taxpayer were denied. Aggrieved, the taxpayer filed an appeal before the Tribunal.

Held

(a) Beneficial ownership

The Tribunal perused the agreement between C Limited, UK, and the taxpayer. It observed that the UK company had developed a body of secret, substantial and identifiable know-how in connection with designing, building, operating and maintaining plants for the manufacture of certain products. The UK company wished to develop a sub-licensing market in the Asia-Pacific Region for this know-how, and accordingly wanted the taxpayer to sub-license the know-how. The Tribunal noted that the agreement between C Limited, UK, and the taxpayer allowed it to only sub-license the know-how but did not permit its exploitation. In view of the above, the taxpayer had sub-licensed the know-how to D Private Limited to use along with the technology, and had received 5 percent of the annual net sales from D Private Limited as royalty but, in turn, paid license fees equivalent to only 2 percent of the sales of the product to the UK company. The Tribunal also reviewed the invoices raised by the taxpayer, the documents submitted to the authorised dealer for remittance of the royalty, the certificate issued by the auditor for the payment of royalty under foreign technical collaboration, and extracts of the Singapore tax return wherein credit for tax withheld in India had been claimed in Singapore. In the totality of the above facts and circumstances, the Tribunal held that the taxpayer was the beneficial owner of royalty in line with the provisions of Article 12 of the tax treaty, and the same had to be taxed at 10 percent. In this regard, the Tribunal relied on the ratio laid down in the ABC, *In re* [1997] 228 ITR 487 (AAR) in P. No. 13 of 1995. With regard to interest income, the text of the judgement did not deal with any argument relating to beneficial ownership.

(b) Requirement of a TRC

Another aspect of the issue as stated by the Tribunal was that the benefits available under the tax treaty should have been granted to the taxpayer based on a valid TRC, as was the proposition approved by the SC in the case of Union of India *v.* Azadi Bachao Andolan [2004] (10) SSC 1 (SC). As the taxpayer had placed on record the Singapore TRC for the relevant fiscal year, the Tribunal held that the benefit of the tax treaty was also available to the taxpayer on this ground.

(c) Conduit company

As regards the TO's contention that the taxpayer was a conduit company, the Tribunal relied on its earlier ruling in Shaan Marine Services Private Limited *v.* Dy. DIT [2014] 165 TTJ 952 (Pune) and dismissed the TO's observation.

(d) Remittance of incomes to Singapore

The Tribunal further observed that the case before it was not that the amounts had not been remitted to Singapore, but the fact that the benefits of the tax treaty had been

denied to the taxpayer as said amounts had not been remitted in the relevant fiscal year. The Tribunal found no merit in denying the benefits of the tax treaty to the taxpayer in a situation in which the amounts had been remitted to and taxed in Singapore. In this regard, the Tribunal found support from the ratio laid down by the Rajkot Bench of the Tribunal in Alabra Shipping Pte. Limited, Singapore *v.* ITO (ITA No.392/ RJT/ 2014).

Conclusion

It is thus established that where the taxpayer had entered into an agreement with its principal in the UK and received the know-how, which it was permitted to sub-license, such royalty would be regarded as having been received by the taxpayer in its own right, and eligible for the concessional tax rate prescribed under the tax treaty. Similarly, the interest income earned by the taxpayer, which had been remitted, though not in the same fiscal year, was to be subject to tax at a concessional tax rate.

Editor's note

- *The 2014 update to the OECD's Model Tax Convention, Article 12, considers it to be inconsistent with the object and purpose of the convention for the source state to grant relief/ exemption where the recipient of the income simply acts as a conduit for another person who, in fact, receives the benefits of the income. Where, however, the recipient of the income does have the right to use and enjoy the royalties, unconstrained by a contractual or legal obligation to pass on the payment received to another person, such recipient should be treated as the beneficial owner.*
- *Article 24 of the tax treaty deals with limitation of relief. The exemption or lower rate of tax provided in the tax treaty is not available to a taxpayer unless the income is remitted to/ received in Singapore in cases where the income is subject to tax in Singapore by reference to the amount that is remitted to/ received in Singapore, and not by reference to the full amount (i.e. on accrual).*
- *On a similar issue, the Mumbai bench of the Tribunal in the case of Abacus International Private Limited v. Dy. DIT (ITA No. 1045/ Mum/ 2008) denied the lower rate of tax under the tax treaty as the taxpayer did not establish any proof of remittance to or receipt of interest in Singapore. The Rajkot bench of the Tribunal, in the case of Alabra Shipping Pte. Limited, Singapore (supra), also observed that the onus is on the taxpayer to show that amounts have been remitted to or received in Singapore, but such onus is confined to cases in which income is taxable in Singapore on a limited receipt basis rather than on a comprehensive accrual basis.*
- *The above decision of the Pune Tribunal further lays down that remittance of interest income is important, but it need not be in the same year. A harmonious reading of the above decisions may indicate that so long as the proof of remittance to Singapore is produced, provisions of Article 24 of the tax treaty should not apply even if remittance is in a subsequent year. One may have to wait and watch whether subsequent tribunals or courts' decisions add a "reasonable timeframe for remittance" while applying the provisions of Article 24 of the tax treaty.*

Capital gains

Capital gains on the transfer of development rights is to be computed by considering the market value of land as per municipal records as the full value of consideration; cost of construction of share of the built-up area is not relevant

ACIT *v.* Shankar Vittal Motor Co. Limited [ITA No. 35(Bang) 2015 (Bangalore-Tribunal)]

Upon transfer of development rights (wherein the land owner is entitled to receive a share in the built-up area), the market value of the land should be taken as full value of consideration for computing the capital gains; the cost of construction of the built-up area should not be considered.

Facts

The taxpayer, a company engaged in the business of transport operators, executed a development agreement on 02 February, 2009. Under the development agreement, the taxpayer was to receive a share in the built-up area for transferring the development rights. For the AY 2010–2011, in response to a notice under section 148 of the Act, the taxpayer

filed a revised return of income, in which long-term capital loss was computed based on the guidance value of the land. The TO finalised the assessment, computing the capital gains based on the cost of construction of the built-up area to be received by the taxpayer. The CIT(A) held that capital gains should be computed based on the market value of the land as per municipal records. While deciding, the CIT(A) had opined as below:

- The decision of the Karnataka HC in the case of CIT *v.* Dr. T. K. Dayalu [2011] 14 taxmann.com 120 (Karnataka) relied on by the TO could be distinguished from the taxpayer's case. The HC had decided only on the year of taxability of capital gains. There was no finding regarding the working of capital gains.
- The development agreement was a type of contract agreement wherein the taxpayer would get his share of the constructed property after completion of the project. Whether the project could be completed and whether the developer would honour his commitment was uncertain until the project was completed. Hence, estimating the value of the property even before the taxpayer received it was not realistic.
- On the date of the development agreement, the taxpayer had received only the right to receive a particular constructed area of the constructed building and not the building itself. The value of the constructed building could vary from time to time.
- The right to receive the constructed area could at best be equated with the market value of the property handed over to the developer.
- The CIT(A) also observed that the market value of the property (taxed on the transfer of development rights) should be treated as including the cost of acquisition for the built-up area when received from the developer, or the value of the right to receive the built-up area. Income would be taxed as and when the built-up area or the right to receive the area was sold in subsequent years.

Held

The determination of value was not in dispute. The Tribunal upheld the CIT(A)'s order.

Editor's note

- *In multiple decisions involving transfer of development rights, Tribunals/ HCs have decided on the year of taxability of capital gains. However, the manner of the computation of capital gains has not been addressed by most of appellate authorities. The Bangalore Tribunal's decision gives some guidance on the computation of capital gains. However, there could be alternative mechanisms of computing the full value of consideration (i.e. fair value of the share of the built-up area). Hence, the view adopted by the Bangalore Tribunal may be subject to litigation.*
- *Reference can also be made to section 50D of the Act, as inserted by the Finance Act 2012, which provides that if the consideration received or accruing is not ascertainable or cannot be determined, the fair market value of the asset transferred should be deemed as the full value of the consideration. However, one would also have to examine the implications under section 50C of the Act.*
- *Further, the value considered as the full value of consideration may also have an impact on the service tax liability, if any, on the development agreements.*

In JDAs, capital gains are taxable only if all conditions of section 53A of TOPA are fulfilled; developer to demonstrate willingness to perform its obligations under development agreement

Coromandel Cables Private Limited *v.* ACIT [ITA Nos. 1944 to 1949/ Mds/ 2013 (Chennai-Tribunal)]

The Chennai Tribunal, in the taxpayer's case, held that in case of JDAs, if there was no willingness on the developer's part to perform its obligations under the JDA, it could not be said that the development rights were "transferred" within the meaning of section 2(47) of the Act. Obtaining approval for the building plan was essential to demonstrate willingness on the developer's part to perform its obligations.

Facts

The taxpayer, a company engaged in the manufacture of cables, entered into a JDA with a firm on 23 November, 2005, to develop a residential project. Under the JDA, in consideration for transferring the development rights, the taxpayer was to receive a consideration of 37.54% of the saleable value of the developed property.

The JDA was not registered. The taxpayer had received INR 1 million as a refundable deposit. The taxpayer also entered into an Agreement of Sale for the same land with the same developer on the same date. The taxpayer offered capital gains arising from the Agreement of Sale on the basis of the guideline value for AYs 2008-09 and 2009-10. The TO took the view that there was "transfer" of development rights on the JDA date, and accordingly taxed the capital gains in AY 2006-07. The CIT(A) upheld the TO's order.

Held

The Tribunal held that in order to invoke section 2(47)(v) of the Act, it needed to be demonstrated that the conditions of section 53A of the Transfer of Property Act (TOPA) were satisfied. One necessary condition of section 53A of Transfer of Property Act (TOPA) was willingness on the part of the transferee to perform his/ her part of the contract. In view of the following facts, the Tribunal held that the developer could not be said to have been "willing to perform his part of the contract":

- As per the JDA, the taxpayer had not handed over possession of the property to the developer. Until such possession was handed over, the developer was only licensed to enter the property for the limited purpose of development and construction.
- The taxpayer received a meagre refundable deposit of INR1 million as against the consideration of 37.54% of the sanctionable construction area. Therefore, the same could not be construed as receipt of part sale consideration.
- There was no evidence to show that the developer had obtained approval for the building plan from the municipal corporation before 31 March, 2006 (i.e. during AY 2006-07). As the building plan sanction was of utmost importance to the implementation of the JDA, the very genesis of the Agreement failed in the absence of obtaining this sanction.
- In the absence of approval for the building plan, there was no construction during AY 2006-2007. Thus, the developer incurred no cost of construction in AY 2006-07, and during AY 2006-07, the developer had not shown its readiness to execute the JDA.

The Tribunal held that handing over possession of the property was only one of the conditions of section 53A of the TOPA, but it was not the sole and isolated condition. Further, without accrual of the consideration to the taxpayer, the taxpayer was not expected to pay capital gains on the entire sale consideration. Accordingly, the Tribunal held that capital gains could not be taxed during AY 2006-07.

Editor's note

The Tribunal has re-emphasised that to invoke section 2(47)(v) of the Act, all ingredients of section 53A of the TOPA need to be satisfied. However, at what point of time it could be said that the transferee was willing to perform his/ her part of the contract would depend on the facts of the case. Whether actual obtaining of the plan approval or a step taken by the transferee towards obtaining approval can be considered satisfactory can be a subject matter of litigation with the tax authorities.

Development agreement without passing of possession does not result in transfer liable to capital gains tax

ACIT *v.* Jawaharlal L. Agicha [ITA No. 1844/ Mum/ 2012 (Mumbai-Tribunal)]

A development agreement entered between the owner of land and the developer without passing of possession did not result in transfer of land under section 2(47)(v) of the Act, and therefore was not liable to capital gains tax.

Facts

The taxpayers had purchased two pieces of land in 1994. The lands were fully occupied by slum dwellers and were declared as slums under section 4(1) of the Maharashtra Slum Areas (Improvement, Clearance and Redevelopment) Act. On 07 November, 2007, the taxpayer entered into a development agreement (the Agreement) with the developer. As per the Agreement, the developer was required to

- obtain a Letter of Intent from the Slum Rehabilitation Authority (SRA);

- make arrangements with the slum dwellers for their re-location and construct separate buildings for rehabilitating the slum dwellers; and
- develop other separate residential or commercial buildings that were permitted to be freely sold, by consuming the FSI or by loading outside TDR.

The taxpayers owned two physically separate lands, and the land parcels between the two lands belonged to others. The developer had entered into agreements with other landowners as well. Under the Agreement, the taxpayer was entitled to receive 130,000 sq. ft. of FSI out of the total FSI, and the developer was free to use the remaining land. The land could be used by any person only after statutory permission was issued by the SRA with respect to the development of the land and its free use. No such permission had been issued by the SRA during the year under consideration. The Agreement provided that the taxpayer would be deemed to be in physical and exclusive possession of said property until the permission was received from the SRA. No registered conveyance deed was executed during the year under consideration. The cost of the construction of 130,000 sq. ft. was estimated to be INR0.26 billion. The developer would either incur such cost or provide the funds to the taxpayer for construction. During the relevant year, the taxpayer received INR0.1 billion from the developer and recorded it as an advance. The TO opined that the Agreement gave rise to a transfer of the land. The TO computed capital gains on the sale consideration at INR0.26 billion and levied tax thereon. The CIT(A) held that the Agreement did not give rise to a transfer and was thus not liable to capital gains tax.

Held

Possession of land along with other legal rights entitling the developer to full use and enjoyment of the property and further sale of the developed units at its sole discretion results in "transfer." The Agreement provided that the taxpayer would be deemed to be in physical and exclusive possession of land until the SRA permission was received. As the possession could be given only post SRA permission, the SRA permission had not been received and the revenue had not produced evidence contradicting the above findings, it was held that the taxpayer had not parted with possession. As physical possession of land was held by the slum dwellers and there was nothing to show that the taxpayer could have given physical possession, it was held that possession of land was not given to the developer. Without transfer of physical possession, the applicability of section 2(47)(v) of the Act became doubtful (Ajay Kumar Shah Jagati *v.* CIT [2008] 168 Taxman 53 (SC)). The effect of non-registration of the agreement could lead to holding that there was no transfer under section 2(47)(v). Therefore, it was held that no transfer of the impugned land had taken place during the year under consideration. The Revenue's Appeal was therefore dismissed.

Editor's note

This decision reiterates the principle that for a transaction to be regarded as "transfer" under section 2(47)(v) of the Act, all conditions of section 53A of the TOPA, should be satisfied, and possession of the property should be obtained by the transferee in part performance of the contract.

Notified jurisdictional area

Madras HC dismisses writ petition challenging notification of Cyprus as a Notified Jurisdictional Area under section 94-A

T. Rajkumar *v.* Union of India, Ministry of Finance [W.P.Nos.17241 to 17243 & 17407 to 17412 of 2015 (Madras)]

Facts

The three petitioners had entered into an agreement dated 16 October, 2014, to purchase equity shares and compulsorily convertible debentures (CCDs; the securities) in A Limited, an Indian company, from B Limited, a company incorporated in Cyprus. B Limited incurred a capital loss on the transfer of the securities to the petitioners. The consideration was remitted to B Limited by the three petitioners without withholding any taxes on such remittance as required under section 94-A of the Act, read with the Notification specifying Cyprus as a NJA. Each petitioner received a show cause notice inviting their attention to section 94-A(1) of the Act and the notification and asking them to show cause as to why they should not be treated as taxpayers in default, thereby warranting initiation of proceedings

under sections 201(1)/ 201(1A) of the Act. The petitioners contended before the TO that B Limited had incurred a capital loss on the transfer of securities and that they would have been obliged to withhold tax only if the payment made to B Limited was chargeable to tax under section 195 of the Act. The TO passed orders against each petitioner under sections 201(1)/ 201(1A) of the Act and raised a notice of demand for payment of tax and interest due. In response, the petitioners filed an appeal before the CIT(A) and a writ petition before the Madras HC, challenging the validity of section 94-A, the Notification and the Press Release. Simultaneously, they also filed writ petitions challenging the demand notices and order passed under sections 201(1) and 201(1A) of the Act.

Held

(a) Constitutional validity of section 94A of the Act

Based on certain SC judgments (Jolly George Varghese *v.* The Bank of Cochin [AIR 1980 SC 470] and State of West Bengal *v.* Kesoram Industries Limited [2004] (10) SCC 201), it was held that the Indian Constitution followed a dualistic doctrine with respect to international law. Hence, an international tax treaty could be enforced only so long as it was not in conflict with the domestic laws of the State. In this regard, the SC had cited its own earlier observations in the case of Union of India *v.* Azadi Bachao Andolan [2004 (10) SCC 1]. The HC observed that while section 90(1) of the Act dealt with the delegation of powers to the CG to enter into an agreement, section 94A(1) of the Act dealt with the delegation of powers to specify a country as an NJA. It observed that no question had arisen directly in the SC's judgements in the case of Union of India *v.* Azadi Bachao Andolan [2004] (10) SCC 1 and in CIT *v.* P.V.A.L.Kulandagan Chettiar [2004] (6) SCC 235 as to whether or not the Parliament had the power to make a law in respect of a matter covered by a tax treaty. The observations in these two decisions, to the effect that the tax treaty would have an effect even if they were in conflict with the provisions of the statute, could not be stretched too far to conclude that the Parliament did not have the power to make a law in respect of a matter covered by a tax treaty. Further, India had not ratified the Vienna Convention. Even if the rule of *Pacta Sunt Servanda* was invoked, the petitioners would not be in a favourable position, as the Convention obliged both the contracting parties to perform their obligations in good faith. One of the four purposes for which a tax treaty could be entered into by the CG under section 90(1) of the Act was for the exchange of information. If one of the parties to the tax treaty failed to provide necessary information, then it was in breach of the obligation under Article 26 of the Vienna Convention. Consequently, the Vienna Convention could not be invoked to prevent the other contracting party from taking recourse to domestic law to address the issue. It could not be argued that section 94A(1) of the Act had diluted section 90(1) of the Act; instead, it was diluted by one of the contracting parties by its failure to provide the requested information, as the purpose of the CG entering into a tax treaty under section 90(1) of the Act was defeated by the lack of exchange of information. Further, relying on certain resolutions adopted by the leaders of G20 Nations in a Summit at London on 02 April, 2009, and the Explanatory Notes to the provisions of the Finance Act 2011, which had introduced section 94A, the HC noted that section 94A was inserted to give effect to the resolution passed by the G20 Nations in order to take action against non-cooperative jurisdictions, including tax havens. Furthermore, the HC observed that India was not the only country that had taken defensive measures to prevent the abuse of the benefits conferred by tax treaties. It, therefore, dismissed the writ petition challenging the constitutional validity of section 94A of the Act.

(b) Validity of the notification dated 01 November, 2013

The language of section 94A of the Act left no room for doubt about the power conferred to the CG to issue a notification. Further, this conferred power could not be said to be uncontrolled and unbridled, as the CG could exercise the power only in circumstances in which there was lack of effective exchange of information. Article 28 of the tax treaty contained an obligation for the exchange of information between the two countries, and the Notification was issued by the Indian CG on account of the Cyprus Government's failure to honour its commitment

under the tax treaty. When one of the parties committed a default by failing to provide information, it was not open to the beneficiary of such a default to contend that the other contracting party should honour its obligations. The HC observed that the lack of exchange of information, which led to the issuance of the Notification, would not fall under the categories mentioned in paragraph 3(b) of Article 28 of the tax treaty, that is, it was not obtainable under the laws or in the normal course of administration. Information relating to evasion of tax could not fall under this category. Paragraph 03 of Article 27 of the tax treaty, which prescribed a MAP in case of disputes, dealt only with "difficulties or doubts arising as to the interpretation or application of the agreement", and did not deal with the failure of one of the contracting parties to honour its commitment. Furthermore, the MAP provisions under the tax treaty did not oust the jurisdiction of Parliament to enact a law and of the executive to issue a notification in exercise of the power conferred by such a law. The HC further held that the phrase used in section 94A(1) of the Act was "any country or territory," which could not be read to mean "any country or territory other than those covered by section 90(1)," and hence the provisions of this section should also apply to countries with whom India has a tax treaty.

(c) Validity of the Press Release dated 01 November, 2013

The HC accepted that the words "sum," "amount," "income" and "payment" had different connotations. However, it noted that section 94A(5) of the Act was worded from the point of view of the recipient of any "sum," "income" or "amount," whereas the Press Release was worded from the point of view of the person making the payment. Though the circulars issued by the CBDT under section 119 of the Act had statutory force, the Press Releases issued by the CBDT for the information of the public did not have the same force. Further, a Press Release was not a legal document but only a note intended for the benefit of the common man. Therefore, the question of assailing the Press Release did not arise. The HC observed that the petitioners should have withheld tax on the payment made to B Limited for the purchase of the securities in A Limited and thereafter taken legal recourse for claim of refund against the income-tax department.

Conclusion

The HC held that section 94A was the need of the hour and thereby dismissed the writ petitions filed challenging the constitutional validity of section 94-A of the Act.

Editor's note

This is an important judgement upholding the validity of section 94-A of the Act and the Notification issued thereunder, the principles of which may have an impact on payments made to Cypriot entities. One important aspect to be kept in mind is that the HC has not gone into the merits of the case in relation to the interpretation of the use of the words "sum or income or amount on which tax is deductible under Chapter XVII-B" in section 94A(5) while dismissing the aforesaid petition.

Given that the notification no. 86 of 2013 wherein Cyprus was considered as a NJA has been rescinded retrospectively, appropriate relief ought to be available to the taxpayer.

Letting out properties

SC reaffirms that income from business of letting out properties should be treated as "profits and gains of business or profession" and not as "income from house property"

Rayala Corporation Private Limited *v.* ACIT [Civil Appeal No.6437 of 2016]

Income from the business of leasing out properties for rental income should be treated as "profits and gains from business or profession" and not as "income from house property."

Facts

The taxpayer, a private limited company, had a house property and was receiving income from that property as rent. The taxpayer had stopped all other business activities, except leasing of properties, and was earning only rent from the properties. On appeal before the HC, it held that the rental income earned by the taxpayer should have been treated as "income from house property." On further appeal before the SC, the taxpayer contended that the rental income was taxable as "profits and gains from business or profession" as the taxpayer was in the business of renting out

properties. The taxpayer placed reliance on the SC's earlier rulings (Chennai Properties and Investments Limited *v.* CIT [2015] 373 ITR 673 (SC) and Karanpura Development Co. Limited *v.* CIT [1962] 44 ITR 362 (SC)). The taxpayer also submitted that even as per its Memorandum of Association, its business was to deal in real estate and to earn income by way of rent from leasing or renting properties belonging to it. On the other hand, the Revenue, relying on another SC ruling (M/s SG Mercantile Corporation (P) Limited *v.* CIT [1972] 1 SCC 465), contended that the rent should be the primary source of income, or that the purpose for which the company was incorporated should be to earn rental income, for rental income to be taxable under the head "profits and gains of business or profession." The Revenue contended that leasing and letting out of shops and properties was not the taxpayer's primary business as per the Memorandum of Association, and, therefore, the income earned by the taxpayer should be treated as income earned from house property.

Held

On a recent SC decision in which the SC reaffirmed its decision in an earlier case considering its previous decisions (Chennai Properties and Investments Limited *v.* CIT [2015] 373 ITR 673 (SC) and Karanpura Development Co. Limited *v.* CIT [1962] 44 ITR 362 (SC)) referred to by the taxpayer, it was observed that the law laid down in the case of Chennai Properties and Investments Limited *v.* CIT [2015] 373 ITR 673 (SC) showed the correct position. The taxpayer's case was squarely covered by the aforesaid ruling, wherein it was held that if letting out of properties was the business of the taxpayer, then its income would be chargeable to tax under the head "profits and gains of business or profession" as opposed to "income from house property." Keeping in view the above judgment and the facts of the taxpayer's case, the SC ruled that the business of the company was to lease its property and to earn rent, and therefore, the income so earned should be treated as its business income.

Editor's note

The recent judicial trend, including this ruling, appears to affirm the position that income from letting property should be taxed as "profits and gains from business or profession" and not as "income from house property" if the taxpayer is in the business of leasing property. However, we expect that this issue would continue to be litigated on account of possible divergent views. One has to look at the specific facts of each case, including the objects of the company as per its charter documents, to take a position on the taxability of rental income.

Actual letting out of property during the year not necessary for claiming vacancy allowance while computing "income from house property"

ITA No. 747/ PN/ 2014

The ALV of a property that was vacant during the entire year was to be considered as Nil if the taxpayer intended to, and had taken appropriate efforts to, let the property out.

Facts

The taxpayer, an individual, *inter alia*, owned two commercial properties at Nashik, *viz.* Property 1 and Property 2. Both these properties remained vacant during AY 2009-10. The taxpayer claimed the ALV for both properties as "Nil" under section 23(1)(c) of the Act. During the assessment proceedings, the TO held that section 23(1)(c) of the Act was not applicable in a situation in which the property was not let out during the year. Accordingly, the TO determined the ALV of the properties as below:

Property	ALV	Basis
Property 1	INR 96,000	*Ad hoc* valuation
Property 2	INR 151,200	Based on the actual rent received by the taxpayer during AY 2007-08

The CIT(A) determined the ALV of Property 1 at INR 40,000, which was agreed to by the taxpayer. The CIT(A) upheld the ALV of Property 2 at INR 151,200 as adopted by the TO. The CIT(A) relied on the decision of the Andhra Pradesh HC in the case of Vivek Jain *v.* ACIT [2011] 337 ITR 74 (AP).

Held

The Tribunal held that section 23(1)(c) of the Act also covered a situation in which the property had remained vacant during the whole year. The relevant extract of

section 23(1)(c) of the Act, on which the Tribunal relied, is reproduced below:

"23(1)(c) where the property or any part of the property is let and was vacant during the whole or part of the previous year…"

The Tribunal interpreted the provisions of section 23(1)(c) of the Act and held the following:

- A situation in which the property was let during the previous year could not co-exist with one in which it was also simultaneously vacant for the whole year. The words "let" and "vacant" were mutually exclusive.
- The underlying principle of the section had to be viewed with regard to the intention along with the efforts put in by the taxpayer in letting out the property.
- If the taxpayer intended to let the property and took appropriate efforts towards letting the property but ultimately failed to let the same, then the actual rent received would have to be considered as Nil (being less than the sum that might reasonably be expected to be received on letting the property).
- The expression "property is let" did not mean actual letting out of the property. While concluding thus, the Tribunal considered the language of section 23(3) of the Act, wherein the words used were, "house is actually let out." If "property is let" were to be interpreted to mean the actual letting of the property, then there would have been no need to use the word, "actually" in section 23(3) of the Act.

Property 2 was let out by the taxpayer in earlier years, revealing the intention of the taxpayer to let out the same. Thus, the Tribunal held that the ALV of that property had to be taken as Nil.

Editor's note

The Tribunal interpreted section 23(1)(c) of the Act to include a situation in which the property had remained vacant during the entire year, if the taxpayer had demonstrated the intention to let out the property. This interpretation can be a positive one for taxpayers (including real estate developers having vacant commercial properties) wherein the notional income may not be subject to tax for vacant properties as "deemed to be let out properties." However, one will have to examine whether this interpretation can be extended to real estate developers having unsold stock of finished flats where, based on the decision of the Delhi HC in the case of CIT v. Ansal Housing Finance and Leasing Co. Limited and Ansal Properties and Indus Limited and Ansal Housing and Construction Limited [2012] 354 ITR 180 (Delhi), the notional income can be taxed on account of such finished flats as "deemed to be let out property." It would have to be examined whether the interpretation of the Tribunal of the "intention to let out, together with efforts put in by the taxpayer for letting out" can be extended to the "intention to sell the finished flats together with efforts put in by the taxpayer for selling the same."

"Intent of letting" not enough to claim vacancy rent allowance while computing income under the head "income from house property"

ITA No 6717/ Mum/ 2012 (Mumbai-Tribunal)

To claim vacancy allowance under section 23(1)(c) of the Act, the property should actually be let out during the financial year. Mere "intention to let out" was not sufficient to claim vacancy allowance.

Facts

The taxpayer purchased two properties in Mumbai on 18 December, 2008. One of the properties was purchased with the intention of letting it out to earn rental income. The taxpayer had also entered into negotiations for letting out said property. The same was let out with effect from 01 April, 2009. During the assessment proceedings, the TO computed the annual value of the property for the period from January 2009 to March 2009 and sought to tax the same in the taxpayer's hands.

Held

The Tribunal held that the basis of charge in respect of a house property was its annual value, that is, the income potential as reflected in its fair rental value (the rent at which it may reasonably be expected to be let from year-to-year). This was irrespective of whether the property had actually been let out (subject to exception of one house property). The Tribunal held that the words, "where the property is let" in sections 23(1)(b) and 23(1)(c) of the Act represent a state of "actual letting" and could not be extended to a state of "intended letting." The Tribunal

followed the decision of Andhra Pradesh HC in the case of Vivek Jain *v.* ACIT [2011] 337 ITR 74 (AP) as against its own decision in the case of Premsudha Exports (P.) Limited *v.* ACIT [2007] 295 ITR 341 (Mumbai) by according a higher precedential value. The Tribunal held that the decisions relied upon by the taxpayer were rendered without considering the decision of the HC in the case of Vivek Jain (*supra*).

Editor's note

The issue of "actual letting" v/ s "intended letting" has been a subject of dispute before the tax authorities. Recently, the Pune Tribunal [Vivek Jain (ITA No. 747/ PN/ 2014)] after taking into account the conflicting decisions in the case of Premsudha Exports (P.) Limited v. Asst. CIT [2007] 295 ITR 341 (Mumbai) and Vivek Jain (supra) *had held that the "intention to let out" should be sufficient to claim vacancy allowance under section 23(1)(c) of the Act.*

Upfront charges

Upfront charges paid by an SEZ co-developer towards allotment of land under a 99-year lease long with certain rights is not "rent" and does not require tax deduction at source

Foxconn India Developer Private Limited *v.* ITO [Tax Case Appeal No. 801 OF 2013 (Madras)]

One time, non-refundable, upfront charges paid by the taxpayer, a SEZ co-developer, towards the allotment of land under a 99-year lease along with certain rights, was held not to be "rent" and hence did not require tax to be withheld.

Facts

The taxpayer was chosen as a "co-developer" by the Government of Tamil Nadu to establish a "project-specific SEZ" in partnership with the State Industries Promotion Corporation of Tamil Nadu Limited (SIPCOT). Thereafter, the taxpayer signed a MoU with SIPCOT to act as its co-developer for the development of a project-specific SEZ. Pursuant to the above, the taxpayer applied to SIPCOT for the allotment of land, based on which SIPCOT allotted a land parcel of 151.85 acres vide two allotment orders. These allotment orders required the taxpayer to pay one-time, non-refundable, upfront charges. The lease deed would be executed after payment of 100% of the upfront charges. After payment of the upfront charges, SIPCOT executed lease deeds granting leases over the said land parcel. Under these lease deeds, the taxpayer was entitled to enjoy the land for 99 years upon payment of lease rent of INR 01 per year for 98 years and INR 2 per year for the 99th year, in addition to the payment of upfront charges as discussed above. The taxpayer did not withhold tax on payment of the upfront charges, as the same was not construed as rent by both, the taxpayer and SIPCOT. The TO concluded the assessment proceedings by holding that upfront charges would be characterised as rent, on which taxes should have been withheld under section 194-I of the Act, failing which the taxpayer was required to pay the withholding tax along with interest thereon. On appeal, the CIT(A), after observing that SIPCOT had already offered upfront charges to tax, held that no withholding tax could be recovered from the taxpayer, but sustained the interest payment on withholding tax. The Tribunal also affirmed the CIT(A)'s order.

Held

The HC, after going through the SC ruling in the case of CIT *v.* Panbari Tea Co. Limited [1965] 57 ITR 422 (SC), which pointed out the distinction between "premium" and "rent", and deduced that the substance of the transaction was more important than its form. The HC therefore held that one-time, non-refundable, upfront charges paid by the taxpayer with regard to an immovable property were not to be characterised as rental income obliging the payer to withhold tax, as upfront charges paid by the taxpayer were

- not under the lease agreement;
- not merely for the use of the land; and
- for several purposes such as (a) becoming a co-developer; (b) developing a SEZ; and (c) for putting up an industry in the land.

The lessor as well as the lessee intended to treat the lease as "deemed sale." Hence, the taxpayer was not obliged to withhold tax and, accordingly, was not to be treated as a taxpayer-in-default.

Editor's note

Section 194-I of the Act clearly provides that payment made by a person should be in the nature of "an income by way of rent" to attract withholding tax provisions. Applicability of withholding tax provisions on lease premium has been a subject matter of debate at various fora. The ruling of the Madras HC seeks

to provide some clarity on this issue. It is important to note that the HC in the present case has made an attempt to distinguish between "upfront charges paid to acquire land with a 'bundle of related rights'" and "upfront payment for acquisition of leasehold rights." The HC has observed that the payment was not for mere use of land but for a variety of purposes in relation to the SEZ development.

Compensation to tenants

Compensation paid by developers to tenants for alternative accommodation not in nature of rent; section 194-I of the Act inapplicable

I.T.A. No. 5963/ Mum/ 2013 (Mumbai-Tribunal)

Compensation paid by the taxpayer towards alternative accommodation under a development agreement was not in the nature of rent covered under the provisions of section 194-I of the Act. Hence, no disallowance could be made under section 40(a)(ia) of the Act for non-withholding of tax.

Facts

The taxpayer was a company engaged in the business of development of real estate, including carrying out Slum Rehabilitation Projects (SRA projects). The taxpayer was required to provide flats to the hut-dwellers for Nil consideration under SRA Projects. The land/ property in question for one such SRA project was owned by the municipal corporation, and the inhabitants of said building were tenants of the municipal corporation. As per the terms of the development agreement, the taxpayer was also required to provide alternative accommodation to the tenants during the construction period. However, as the taxpayer was unable to provide alternative accommodation to the tenants, the taxpayer agreed to pay them compensation (revised from time to time) to enable them to meet the expenditure to be incurred towards rent. During AY 2010-11, the taxpayer had not withheld tax on payment of such compensation. The TO held that said payment was in the nature of "rent," and hence tax was required to be withheld under section 194-I of the Act. Accordingly, the TO made a disallowance under section 40(a)(ia) of the Act. The CIT(A) upheld the disallowance made by the TO.

Held

On account of the reasons listed below, the Tribunal held that the payments made by the taxpayer were not in the nature of "rent" as per section 194-I of the Act:

- The concerned persons to whom the taxpayer had made the payments were neither tenants of the taxpayer nor had the taxpayer paid rent on their behalf in reality. Such compensation was payable by the taxpayer irrespective of whether the tenants actually incurred any expenditure on account of rent or not.
- As per Explanation 1 to section 194-I of the Act, "rent" *inter alia* included payment for use of land or building. The taxpayer had not made the payment for use of any land or building. Therefore, the payment was not in the nature of "rent" but in the nature of compensation.

The Tribunal relied on the decision in the case Jitendra Kumara Madan *v.* ITO [2012] 32 CCH (Mumbai-Tribunal). Accordingly, the Tribunal deleted the disallowance made under section 40(a)(ia) of the Act.

Editor's note

The Tribunal has attempted to create a distinction between "rent" and "compensation" in the context of redevelopment projects. Payments made by the developers to tenants/ members of the society for arranging alternative accommodation should not be regarded as "rent," being subject to deduction of tax at source under section 194-I of the Act. This distinction between "rent" and "compensation" is important, as withholding tax under section 194-I of the Act would affect the net cash flows in the hands of the tenants/ members of the society. In view of the introduction of section 194-IA of the Act with effect from 01 June, 2013, it needs to be analysed whether, going forward, such payments (held to be in the nature of "compensation") should be subject to deduction of tax at source under section 194-IA of the Act.

Business income

Share capital issued with attached occupancy rights was capital receipt and ought not to have been treated as business income

G S Homes & Hotels Private Limited *v.* DCIT [2016] 73 taxmann.com 120 (SC)

Amount received on account of share capital, though attached with the right to occupy property owned by the issuing company, ought not to have been treated as business income.

Facts

The taxpayer, a private limited company, was incorporated with the object of a real estate agency. The taxpayer developed a complex for the benefit of shareholders on the land it owned. The complex was developed out of the share capital/ deposits received from shareholders. The floor area of the complex, in proportion of the number of shares, was allotted to shareholders, and deposits were collected in proportion to the floor area allotted. A maintenance deposit was also collected for the upkeep of the building. Pursuant to allotment of the floor area, shareholders were entitled to use and enjoy the premises, amenities and common area. The taxpayer had retained, and not transferred, the ownership rights. The TO held that the surplus out of the construction funds, that is, the difference between share capital/ deposits received and the expenses on construction, was taxable as business income. Similarly, surplus from the maintenance activity was also taxed as business income.

Held

The amounts received on account of share capital from shareholders were capital receipts and should not have been treated as business income. The SC confirmed that the maintenance deposited was income chargeable to tax.

Editor's note

The SC has held that the share capital received, even though attached with the right to occupy a property, was a capital receipt and therefore, ought not to have been taxed as a business income. This settles the issue as to the basic nature of the receipt, and it may be very useful in settling litigation on taxability of receipts on account of share capital.

Income from house property

Maintenance charges received in relation to the property should be regarded as "rent" for computing income taxable under the head "income from house property"

Sunil Kumar Gupta *v.* ACIT [ITA No. 369 of 2015]

Maintenance charges received in relation to the property should have been included within the ambit of "rent" and be taxed under the head "income from house property."

Facts

The appellant (a "deemed owner" as per section 27 of the Act) had taken on sub-licence an apartment in a commercial building (property) from a builder. The appellant entered into a sub-sub-licence agreement for sub-leasing the property. As per the agreement, the sub-sub-licensee was liable to pay the following sums in relation to the property:

- Agreed monthly rent to the appellant; and
- Monthly maintenance charges as would be payable directly to the builder.

Pursuant to an understanding between the appellant and the sub-sub-licensee, the maintenance charges were paid by the sub-sub-licensee directly to the builder. The maintenance charges were regarded as rent of the property and were taxed in the hands of the appellant under the head "income from house property."

Held

The HC observed the following while deciding that the maintenance charges should have been regarded as "rent" and be taxed under the head "income from house property":

- For the purpose of sections 22 and 23 of the Act, the ambit of the term "rent" is very wide. It includes any amount that was paid in consideration of the property being let.
- Where the legislature intended to provide a deduction for any amount, it has specifically provided for the deduction. For example, the proviso to section 23(1) of the Act provides for deduction of property tax. The proviso does not provide for deduction of maintenance charges.
- Rent of a property was dependent on the facilities of the building. The better the facilities, the qualitatively and/ or quantitatively higher the rent.

- Where the agreements provided that the owner shall pay the amounts for common facilities, maintenance charges, etc., it was presumed that the same had been factored into the rent. In such an event, the same could not be added to the rent agreed to be paid. However, if the maintenance charges were payable separately, then it must form a part of the rent for the purpose of computing the annual value of the property.
- If maintenance charges were not included in the rent, then it would enable a taxpayer to avoid paying tax on the true annual value of the property, as the annual value would be lower.

Editor's note

One of the key requirements for taxing income under the head "income from house property" is that the income should be earned by the taxpayer in his/ her capacity as the "owner" or "deemed owner" of the property. In case the taxpayer is not the "owner" or "deemed owner" of the property, then the charging section of the head "income from house property" should not apply. In the present case, we presume that the appellant qualified as a "deemed owner" of the property as per section 27 of the Act. Therefore, the HC has not analysed the taxability of the income under the head "income from other sources."

Further, the HC has interpreted that the maintenance receipts are to be regarded as "rent" and should be taxed under the head "income from house property." One would have to examine whether this principle can be extended to property owners earning rental income and maintenance charges, wherein the rental income in certain circumstances should be taxed as business income, taking into account the SC decision in the case of Chennai Properties and Investments Limited v. CIT ([2015] 373 ITR 673 (SC)). The principles laid down by the Punjab & Haryana HC may not be applicable to all situations in which the maintenance is payable separately by the tenant. The applicability of the principles would need to be examined based on the facts and circumstances of each case.

Notifications and circulars

FATCA

FATCA & CRS update: CBDT issues updated Guidance Note for implementation of rules for FATCA & CRS reporting in India

Guidance note on implementation of reporting requirements under rules 114F to 114H of the Income-tax Rules, 1962

During 2015, the Indian Revenue Authorities had amended the Rules, to enact the FATCA and the CRS in India (for the notified rules on FATCA reporting, you may refer to our news alert dated 11 August, 2015) and subsequently released a Guidance Note for the same on 31 August, 2015. Further, on 31 December, 2015, the Indian Revenue authorities, *vide* a press release, issued a detailed Guidance Note on the implementation of FATCA and CRS reporting requirements as prescribed under the Indian income-tax rules. The objective of this Guidance Note is to provide more clarity on the specific definitions and related implementation guidelines with illustrative examples for the benefit of Indian financial institutions. Some of the key issues clarified in the Guidance Note are as follows:

- **Financial institutions have been inclusively defined as follows:**

Depository institution	Savings banks, commercial banks, savings and loan associations and credit unions. Importantly, a NBFC that accepts deposit in the course of a banking business or a similar business is also considered a depository institution.
Specified insurance company	An insurance company that is obligated to make payment with respect to a cash value insurance contract or annuity contract but excludes insurance companies that only provide general insurance or term-life insurance products, indemnity reinsurance contracts and specified single-premium life insurance contracts.
Investment entity	Collective investment vehicles, mutual fund, exchange traded fund, hedge fund, venture capital fund, private equity and leveraged buyout fund. Importantly, an NBFC working as an investment entity would also qualify under this category.
Custodial institution	Central securities depositories, custodian banks, brokers and depository participants.

- **Financial institution that is involved in more than one category of activity**

  Where a reporting entity qualifies for more than one category of financial institution [e.g., (i) depository institution and (ii) custodial institution], while the reporting entity would register with U.S. Internal Revenue Service under a single Global Intermediary Identification Number, it would need separate registrations for each category with the Indian tax authorities. Such entity would also need to submit a separate Form 61B for each category of registration with the Indian tax authorities.

  Furthermore, in a scenario in which a reporting entity qualifies as a financial institution under a specific category, but maintains multiple categories of reportable accounts such as depository accounts, custodial accounts, etc., the Guidance Note specifies that while that the reporting entity would only need to register itself under the specific category of financial institution, it would, however, need to report both categories of accounts under this registration.

- **Draft self-certification forms**

  A template for self-certification forms for individuals and entities has been prescribed as part of the Guidance Note. While adopting the template provided, financial institutions may also consider the inclusion of additional criteria/ requirements for making the documentation more robust.

  Please refer to Appendix D and E of the updated guidance note: http://incometaxindia.gov.in/news/guidance-note-for-fatca-crts-31-12-2015.pdf

Subsequent developments

Vide notification number F.No. 504/ 090/ 2007-FTD-I dated 19 February, 2016, the Indian revenue authorities have issued another clarification on the following issues:

- Reportable currency for the May 2016 reporting would be in Indian rupees. Form 61B and the Schema would be suitably modified to include a field for capturing types of currencies for reporting in 2017.
- **In case of accounts opened with the local custodian through the Global Custodian (GC),** the local sub-custodian may carry out due diligence by relying on the KYC/ FATCA/ CRS documentation done by the GC for the account holders, including self-certification. However, the ultimate obligation for due diligence and reporting would lie with the local custodian, who should also be able to access all documents in relation to an account.

Vide notification number 48/ 2016] [F.No.142/ 6/ 2016-TPL] dated 20 June, 2016, the Indian revenue authorities extended the timelines to complete the due diligence for pre-existing high-value individual and entity accounts (from CRS perspective) from 30 June, 2016, to 31 December, 2016.

Vide press release dated 31 August, 2016, the Indian revenue authorities extended the due date (under FATCA regulations) for the closure of all individual and entity accounts opened from 01 July, 2014, to 31 August, 2015. The press release stated that the due date of 31 August, 2016, would be extended up to a future date, which would be notified in due course.

Editor's Note

The latest Guidance Note issued by the Indian revenue authorities discusses and explains various provisions of the rules in detail, and provides considerable insight into Indian financial institutions. The Indian revenue authorities have requested stakeholders to provide suggestions so that the Note can be further amended to consider evolving issues in FATCA and CRS implementation. It is imperative for Indian financial institutions to review whether their present FATCA and CRS compliance programs, procedures, IT systems, etc., are fully equipped to handle the reporting requirements. As the time for reporting under FATCA and CRS ends on 31 May following the end of the respective calendar year, it is important for, financial institutions to ensure that their systems are fully upgraded to meet the implementation requirements.

Fund management

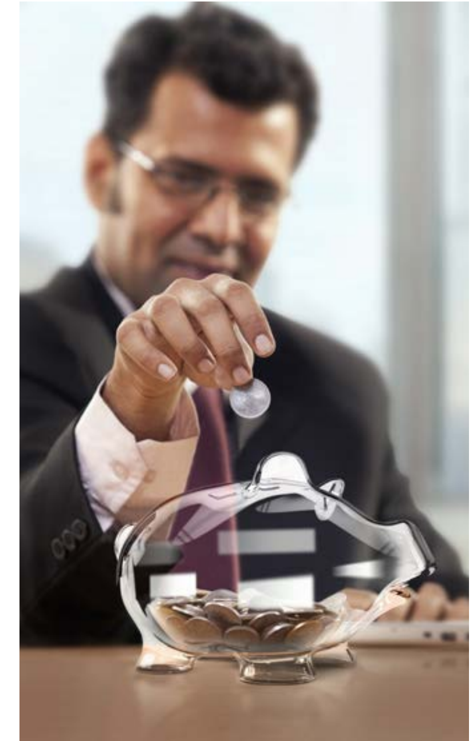
Fund management activities – Safe Harbour Rules prescribed

Notification No. S.O. 1101(E)

The CBDT issued a notification on 15 March, 2016, prescribing the Rules for application of section 9A of the Act, dealing with the taxation of offshore funds in India.

Section 9A of the Act encapsulates safe harbour provisions whereby an EIF shall not be regarded as a tax resident in India merely because an EFM undertaking fund management activities on its behalf is located in India. Benefits under the safe harbour provisions are subject to compliance with certain conditions. Further, these provisions are to be applied in accordance with the guidelines to be prescribed by the CBDT. The CBDT has now issued detailed Rules for the application of such safe harbour provisions.

Given below is the tabulation of the provisions enumerated in the Rules against the relevant provisions of section 9A:



Sub-section of section 9A	Existing provision in the Act	As per the Rules notified
(3)(a)	The fund should not be a person resident in India.	No change
(3)(b)	The fund should be a resident of a country or a specified territory with which India has a Double Taxation Avoidance Agreement, or the fund should have been established, registered or incorporated outside India in a country or a specified territory notified by the Central Government.	No change
(3)(c)	The investment in the fund by persons resident in India, directly or indirectly, should not exceed 5% of the corpus of the fund.	a. If the direct investor in the fund is other than a natural person, the fund shall undertake appropriate due diligence to ascertain the indirect participation of resident Indian investors in the fund. However, declaration from the direct investor shall be sufficient if such direct investor is the Government or Central Bank or sovereign fund, or a multilateral agency, or an appropriately regulated investor (clause c).
(3)(d)	The investor protection regulations of the applicable country or specified territory should be applicable to the fund and its activities.	
(3)(e)	The fund should have at least 25 members who are not connected directly or indirectly.	b. Where the investment in the fund has been made directly by an institutional entity, investor diversification-related conditions (clauses e, f and g) in the fund and the requirements of resident Indian investors not being more than 5% (clause c) in the fund could be looked-through at the institutional entity level (subject to certain conditions). “Institutional entity” is not defined in the Rules notified. c. Non-fulfilment of the investor diversification-related conditions (clauses c, d and e) for funds newly set up, till a period of 18 months or till final closing, whichever is earlier, or funds that are in the process of being wound up, for a period of one year, or the funds that cannot meet the conditions for reasons beyond their control, does not disentitle them to claim the benefits of such provisions.
(3)(f)	The members, along with their connected persons, should not have participation interest in the fund, directly or indirectly, by more than 10%.	
(3)(g)	The aggregate participation of the members along with their connected persons, directly or indirectly, in the fund should be less than 50%, and the number of such members should be 10 or less.	
(3)(h) and (i)	The fund should not invest more than 20% of its corpus in any entity, and the fund should not invest in its associate entity.	No change

Sub-section of section 9A	Existing provision in the Act	As per the Rules notified
(3)(j)	The fund should have a monthly average corpus of INR1 billion or more with an exception that start-up funds can have a corpus of INR1 billion or more at the end of such previous year.	No change
(3)(k)	The fund should not manage or control, directly or indirectly, any business in India.	A fund will be said to be controlling or managing a business carried out by any entity in India if the fund directly or indirectly holds 26% or higher of the voting rights or share capital or an interest in such entity.
(3)(l)	The fund should not carry on any activity that constitutes a business connection in India, other than the activities conducted by the EFM in India on its behalf.	No change
(3)(m)	The remuneration payable by the EIF to the EFM should be at arm's length price.	For determination of the arm's length price of the remuneration, the fund and the fund manager are considered as associated enterprises, and the transaction is regarded as an international transaction. The fund manager is required to comply with the transfer pricing provisions and is required to submit an additional report *via* Form 3CEJ. The safe harbour benefits availed by the fund will be impacted only if the remuneration paid or payable by the fund to the fund manager has been determined to be not at arm's length price for a period of three consecutive previous years, or for any three out of the preceding four previous years.
(4)(b)	The fund manager should be registered in accordance with the Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993, or with the Securities and Exchange Board of India (Investment Advisers) Regulations, 2013.	No change
(4)(d)	The fund manager, along with connected persons, should not be entitled to receive, directly or indirectly, more than 20% of the profits accruing or arising from the EIF.	No change
(5)	The fund should submit a statement within 90 days from the end of the financial year, in the prescribed form, containing information relating to fulfilment of the conditions specified.	The benefits would continue to apply even in an event of delay in furnishing such statement, if the delay does not exceed 90 days.

Pre-approval

The CBDT notification provides for a pre-approval mechanism under which a fund can seek approval at its option from the CBDT regarding its eligibility for the safe harbour, and once approved, benefit under section 9A would not be denied unless such approval is withdrawn. It is pertinent to note that such approval can be obtained only if the conditions mentioned in section 9A are satisfied. Further, an application for pre-approval needs to be made three months prior to the beginning of the FY for which the fund is seeking approval.

Editor's note

The Safe Harbour Rules notified by the CBDT address some of the key concerns raised by the asset management industry and may pave the way for operationalisation of the regime. However, some conditions relating to investor diversification, investment-related conditions, etc., may still need to be liberalised to attract more fund managers to locate to India.

Consultation papers

Consultation paper on continuous disclosures to be made by InvITs issued by SEBI

Continuous disclosures to be made by Infrastructure Investment Trusts

The SEBI (Infrastructure Investment Trust) Regulations, 2014 (InvIT Regulations) provide that a publicly offered InvIT shall ensure that the disclosures in the offer document are in accordance with Schedule III of the InvIT Regulations and any circulars or guidelines issued by the SEBI in this regard.

In view of the above, the SEBI constituted two committees to evaluate the continuous obligations of InvITs under the InvIT Regulations and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2014 (LODR Regulations), and the accounting norms for InvITs. The combined proposals of the above two committees have been set out in a consultation paper issued by SEBI on 15 June, 2016, and have been classified under the following heads:

- Part A: continuous financial disclosures to be made by the InvITs
- Part B: other continuous disclosures to be made by the InvITs
- Part C: framework for the calculation of Net Distributable Cash Flows

The proposals made in the consultation paper are summarised below:

I. ***Part A: Continuous financial disclosures***

Frequency of disclosures

The disclosures to the stock exchanges to be continued to be made on a half-yearly basis, or should be reduced to a quarterly basis.

Time period for disclosures

Disclosures other than annual disclosures should be made to the stock exchanges within 45 days from the end of each quarter/ half year.

Audited standalone FS should be submitted within 60 days from the end of the FY.

Financial statements to be disclosed

Annual FS should include the (i) Balance Sheet, (ii) Statement of Profit and Loss, (iii) Statement of Changes in Equity, (iv) Statement of Cash Flows and (v) Explanatory notes annexed to, or forming part of, statements in (i) to (iv).

InvIT should submit FS on both, standalone and consolidated basis.

FS [(i) to (v) as mentioned above] of the investment manager and project manager should *not* be required to be given by the InvIT unless their net worth is reduced by 50% as compared with their net worth as on the last FY end date.

Audited or limited review of financial statements

InvIT should submit either half-yearly audited results or unaudited results subject to limited review by the statutory auditor along with the limited review report.

Accounting standards to be followed

For InvITs, FS should be prepared in accordance with the Indian Accounting Standards (Ind AS) converged with the International Financial Reporting Standards notified under the Companies (Indian Accounting Standards) Rules, 2015. InvIT should also follow the accounting standards prescribed by their sectoral regulators from time to time.

For SPV, requirements for the preparation of FS would be as applicable.

For consolidation purposes, SPV should provide financial information/ data to InvIT in accordance with Ind AS.

Line items for financial statements

For consistency and uniformity in the presentation of the FS, generic/ basic line items should be prescribed for each of the FS. Illustrative line items have been provided in the consultation paper.

Manner of approval and authentication of financial statements

Financial results to be submitted to the stock exchanges should be signed by two designated personnel of the investment manager certifying that the financial results do not contain any false or misleading statements or figures and do not omit any material fact that makes the statements or figures contained therein misleading.

Thereafter, the chairman of the Board of Directors of the investment manager should sign the FS.

Obligation to maintain proper books of accounts and records, documents, etc.

InvIT should maintain proper books of accounts, records, documents, etc., relating to a period of not less than eight FYs, or if the InvIT has been in existence for a shorter period, then for all the preceding years.

II. ***Part B: Other continuous disclosures***

Listing agreement

InvIT should enter into a simplified listing agreement with the stock exchanges as specified in the SEBI Circular.

For compliance with listing conditions, instead of LODR Regulations, InvIT to follow the InvIT Regulations.

Disclosure of RPTs

In addition to Regulation 19 of the InvIT Regulations for RPTs, additional disclosures for RPTs have been proposed in the consultation paper.

Disclosure of unit holding pattern

Unit holding pattern should be disclosed separately for each class of unit holders, within such intervals and format as prescribed in the consultation paper.

Prior intimations and disclosure of material and price sensitive information

Two working days' prior intimation should be provided to the SE about the meeting of the Board of Directors of the investment manager in which financial results, declaration of distributions, issue of any additional units, buyback of units or proposal for voluntary delisting of units are to be considered.

InvIT should disclose material and price sensitive information as prescribed in the consultation paper.

Credit rating

Every rating to be obtained by the InvIT under the InvIT Regulations with respect to units shall be reviewed once a year by a registered credit rating agency.

Composition of Board of Directors of SPVs

The investment manager shall, in consultation with the trustee, appoint one or more authorised representative(s) on the Board of Directors/ Governing Board of the SPV.

The number of such authorised representatives would be determined on a pro-rata basis depending on the stake held in the SPV, excluding directors nominated by the government or government undertaking for pro-rata calculation.

Website of InvIT

InvIT should maintain a functional website that should be updated up to two days and should contain the prescribed information.

III. ***Part C: Framework for calculation of net distributable cash flows***

The consultation paper proposes a framework for the calculation of NDCFs for InvIT, both at the standalone SPV level as well as at the consolidated InvIT level.

The proposed framework for the computation of NDCFs is intended to be a broad guidance for InvITs. However, the InvIT/ investment manager shall define NDCFs for itself separately in compliance with the Companies Act, 2013, or Limited Liability Partnership Act, 2008, or any Central Government Act, as applicable.

The definition of NDCFs decided by the InvIT/ investment manager shall be disclosed in the offer document and complied with consistently pursuant to listing.

Editor's note

SEBI has consistently followed a consultative approach in formulating regulations for InvITs as well as REITs in India. The release of this consultation paper is another step in the same direction, as SEBI has sought stakeholder comments before finalising guidance on disclosure and other operational aspects for InvITs.

Consultation paper on amendments to the PMS Regulations issued by SEBI

Amendments to SEBI (Portfolio Managers) Regulations, 1993, pursuant to introduction of section 9A in the Act

To encourage fund management activities in India, the Act, *vide* the Finance Act, 2015, introduced section 9A, which, among others, provides that an Eligible Investment Fund (EIF) shall not be regarded as a resident in India merely because the Eligible Fund Manager (EFM), undertaking fund management activities on its behalf, is situated in India.

One of the conditions to qualify as an EFM is that such EFM should be registered as a fund manager or an investment advisor under the SEBI (Portfolio Managers) Regulations, 1993 (PMS Regulations), the SEBI (Investment Advisers) Regulations, 2013 (IA Regulations) or such other regulations made under the Securities and Exchange Board of India Act, 1992, which may be notified by the Central Government.

SEBI had a series of interactions with various stakeholders to discuss the enabling framework for the registration of EFMs. Pursuant to such discussions, to facilitate the management of EIFs by EFMs as envisaged in section 9A of the Act, SEBI issued a consultation paper on 21 June, 2016, proposing certain amendments to the PMS Regulations.

The proposals made in the consultation paper are summarised below:

Insertion of a new chapter

The consultation paper proposes to insert a new chapter in the PMS Regulations, *viz.* Chapter II-A, which will apply to EFMs exclusively pertaining to their activities as portfolio managers to EIFs.

Procedure for an existing Portfolio Manager registered with SEBI

An existing SEBI-registered Portfolio Manager is permitted to act as an EFM with prior intimation to SEBI and submission of certain declarations to SEBI.

Procedure for registration of a fresh applicant or an existing foreign fund manager desirous of relocating to India

Such applicants may be granted registration to act as EFMs, subject to the following:

- Meeting of the existing eligibility norms such as being a body corporate, having net worth of at least INR20 million, appointing a principal officer and at least two employees having requisite qualification and experience, etc.
- Payment of requisite fees
- Submissions of declarations regarding its compliance with the provisions of section 9A of the Act
- Any instructions/ guidelines issued thereunder and requirements as specified by SEBI from time to time

Obligations and responsibilities of the EFM

The EFM may be required to *inter alia*

- Satisfy the requirements specified under section 9A of the Act or any amendment, notification, clarification or guideline issued thereon
- Segregate funds and securities of EIFs from its other clients
- Maintain and segregate its books and accounts pertaining to its activities as a portfolio manager to EIFs and other clients
- Provide certain information in connection with the EIF managed by it to SEBI on a half-yearly basis
- Comply with the Code of Conduct as specified under Chapter III of the PMS Regulations
- Ensure compliance with the Prevention of Money Laundering Act, 2002, and rules and regulations prescribed thereunder

Non-applicability of certain provisions of the PMS Regulations to EFMs

EFMs may be exempted from the following provisions of the PMS Regulations with respect to the EIF:

Exemption from PMS Regulations	Rationale
Requirement of a contract between the portfolio manager and its clients and the contents of such contract [Regulation 14(1)(a), 14(1)(b) and Schedule IV]	This term of the contract may vary depending on the jurisdiction and business requirements of the EIF.
Requirement of providing the disclosure document [Regulation 14(2)(a)]	This may be governed as per regulatory requirements of the jurisdiction of the EIF.
Minimum investment that a portfolio manager can accept [Regulation 15(1A)]	The EIF shall comply with the corpus requirements as specified under section 9A of the Act.
Portfolio manager to act in a fiduciary capacity with regard to the client's funds [Regulation 15(2)]	This may be governed as per the mutually agreed terms and the regulatory requirements of the jurisdiction of the EIF.
Borrowing of funds or securities on behalf of the client; lending clients' securities [Regulation 15(4A) and 15(5)]	This may be governed as per the mutually agreed terms and the regulatory requirements of the jurisdiction of the EIF.
Renewal of portfolio fund on maturity deemed as a fresh placement [Regulation 16(1)(b)]	Not required
Portfolio manager not to enter into a speculative transaction [Regulation 16(4)]	This may be governed as per the investment objective of the fund, mutually agreed terms and the regulatory requirements of the jurisdiction of the EIF.
Portfolio accounts of the portfolio manager to be audited annually and provided to the client [Regulation 20(3)]	Audit of the portfolios of the EIF may be done as per the regulatory requirements of the jurisdiction of the EIF.
Furnishing of certain reports to the client [Regulation 21(1), 21(1A), 21(2), 21(3)	The reports to be provided by the EFM to the EIF may be governed as per the mutually agreed terms.
Circular IMD/ DF/ 13/ 2010 dated 05 October, 2010, dealing with regulation of fees and charges	This may be governed as per the mutually agreed terms and the regulatory requirements of the jurisdiction of the EIF.
Clause (1) of Circular IMD/ PMS/ CIR/ 1/ 21727/ 03 dated 18 November, 2003, dealing with improvement in corporate governance	This may be governed as per the mutually agreed terms and the regulatory requirements of the jurisdiction of the EIF.
Point 5 of Annexure to Circular IMD/ DOF-1/ PMS/ Cir-1/ 2010 dated 15 March, 2010, dealing with reporting of the performance of the portfolio manager	A portfolio manager may not be required to report its performance as an EFM to SEBI.

Editor's note

SEBI has consistently followed a consultative approach in formulating regulations. The release of this consultation paper is another step in the same direction. The amendments proposed by SEBI reflect the endeavour of the Regulator to facilitate fund management activities for offshore funds from India. "Make in India" for the asset management industry in India is one step closer to realisation.

Consultation paper on disclosures to be made by InvITs in offer documents/ placement memoranda and valuation reports issued by SEBI

Consultation paper for the disclosure of financial information in offer documents/ placement memoranda and for valuation in respect of SEBI (Infrastructure Investment Trusts) Regulations, 2014

Close on the heels of releasing the consultation paper on continuous disclosures to be made by InvITs as per the listing requirements and calculation of NDCFs on 15 June, 2016 (please refer our Insight dated 17 June, 2016, for a snapshot of the proposals made in said consultation paper), SEBI issued another consultation paper on 08 July, 2016, proposing a framework for disclosures to be made by SEBI-registered InvITs in offer documents/ placement memoranda and valuation reports. The consultation paper classifies SEBI's proposals under the following two heads:

- Part A: financial disclosures in offer documents/ placement memoranda
- Part B: valuation of the units of the InvITs

The proposals made in the consultation paper are summarised below:

- *Financial disclosures in offer documents/ placement memoranda*

Financial information of the InvIT.

- *Annual financial information*

If the InvIT has been in existence for > = three years, the Audited FS for the last three FYs must be disclosed (standalone as well as consolidated).

If the InvIT has been in existence for < three years, the Combined FS (CFS; assuming that the InvIT structure was in place at the commencement of the reported period) must be disclosed for periods in which the audited FS are not available. The consultation paper provides detailed guidance on the preparation of the CFS.

- *Accounting standards*

The financial information (FS or CFS) should be prepared in accordance with the Ind AS and/ or any addendum thereto as defined in Rule 2 (1)(a) of the Companies (Indian Accounting Standards) Rules, 2015 (Companies Rules).

- *Financial statements and line items*

The financial information (FS or CFS) should include at least the following:

(i) Balance Sheet, (ii) Profit and Loss Statement, (iii) Statement of Changes in Equity, (iv) Statement of Cash Flows and (v) Explanatory notes annexed to, or forming part of, any statements referred to in (i) to (iv) above.

The consultation paper also prescribes a list of line items, which should be included, at the minimum, in each statement referred in (i) to (v) above.

Audit of financial information

An auditor appointed as per the SEBI (InvIT) Regulations, 2014 (InvIT Regulations) should conduct the audit.

The auditor should prepare the audit report in accordance with the *Guidance Note on Reports in Company Prospectuses* that the Institute of Chartered Accountants of India has issued, to the extent applicable.

The auditor should consider the audit reports in the FS of the various InvIT assets in preparing the audit report.

The consultation paper also prescribes a list of items that should be included in the audit report.

- *Additional disclosures*

Operating cash flows from the projects (project-wise) for all InvIT assets that are included in the financial information for the previous three FYs.

Earnings per unit (EPU) for the previous three FYs.

In case of a capital offering subsequent to the initial offer, the market value of the units traded on all designated stock exchanges where the InvIT is listed.

Interim financial information

Audited interim FS must also be disclosed if the date of the draft offer document/ placement memorandum is more than six months from the end of the last FY.

Proposals for the annual financial information (discussed in the paragraph above) should also extend to the interim financial information.

- *Financial information of the Manager and Sponsor*

Summary of the audited consolidated FS (prepared in accordance with the Companies Rules and Companies Act, 2013) of the Manager and Sponsor(s) for the past three FYs should be disclosed in the offer document/ placement memorandum.

In case a Manager/ Sponsor is a foreign entity and not legally required to comply with the Companies Rules, then the FS of such an entity should be prepared in accordance with the International Financial Reporting Standards.

- *Management discussion and analysis*

The InvIT should prepare and disclose the management discussion and analysis (MDA) based on historical FS and provide a comparison of the most recent financial information with the financial information of the previous two FYs.

The consultation paper also prescribes a list of line items that should be included in the MDA.

- *Projections of revenues and operating cash flows*

Projections of revenues and operating cash flows (including related assumptions) of assets, projects owned or projects proposed to be owned prior to the allotment of units in a public offer/ private placement should be disclosed project-wise for the next three years.

The following notes should be disclosed at a minimum as part of the projections: (i) project-wise revenue, (ii) project-wise operating cash flows, (iii) assumptions for projections and (iv) any other item deemed important for better readability and understanding.

- *Payment history and working capital*

The Investment Manager should include a statement regarding the sufficiency of working capital to fulfil the present requirements (for at least 12 months from the date of listing).

If sufficient working capital is not available in the opinion of the Investment Manager, then it should provide a statement describing how it proposes to provide additional working capital.

A statement providing a history of interest and principal payments for the past three FYs should be disclosed.

- *Contingent liabilities*

A statement of contingent liabilities should be disclosed, including their classification into (i) claims against the trust not acknowledged as debt, (ii) other money for which the trust is contingently liable, (iii) any claims against the InvIT pending litigation, and (iv) other contingent liabilities (nature to be specified).

- *Commitments*

A statement of the InvIT's commitments as on the date of the offer document/ placement memorandum should be disclosed, including their classification into (i) estimated amount of contracts remaining to be executed on capital account and not provided for; (ii) uncalled liability on shares and other investments partly paid, including that of SPVs, and (iii) other commitments (nature to be specified).

- *Other disclosures*

The InvIT should comply with the requirements of Ind AS 24 – Related Party Disclosures in the preparation of financial information. For this purpose, it should also provide relevant disclosures for all related parties as defined in the InvIT Regulations. The consultation paper also prescribes a list of line items that should be disclosed in this regard.

A capitalisation statement showing the total debt, net worth and debt/ equity ratios before and after the completion of the issue should be provided. The consultation paper also prescribes an illustrative format for the capitalisation statements.

- *Valuation of the units of the InvITs*

Definition of "valuer"

InvIT Regulations define the term "valuer" as a person who is a registered valuer as per section 247 of the Companies Act, 2013, and has been appointed by the Investment Manager to undertake valuation of the InvIT assets. Until this section comes into force, a SEBI-registered merchant banker or chartered accountant having minimum experience of 10 years can be a valuer.

The consultation paper provides that until section 247 of the Companies Act, 2013, comes into force, the definition of a valuer under InvIT Regulations should be modified to include (i) either a chartered accountant, company secretary or cost accountant who is in whole-time practice or a retired member of the Indian Corporate Law Service, or a person holding equivalent Indian or foreign

qualification that the Ministry of Corporate Affairs may recognise; (ii) a SEBI-registered merchant banker who has employed persons having qualifications prescribed under (i) above; (iii) a member of the Institute of Engineers who is in whole-time practice; (iv) a member of the Council of Architecture or the Indian Institute of Architects; and (v) a person or entity possessing necessary competence and qualification in valuation as the Central Government may have notified.

The persons specified in (i) to (v) should have not less than five years of continuous experience in valuation after acquiring membership of the respective institutions.

Mandatory disclosures in the valuation report

The consultation paper prescribes a minimum set of disclosures to be made in the valuation report (in addition to the disclosures prescribed in Schedule V of the InvIT Regulations).

Further, a brief summary of the valuation should also be provided as part of the valuation report.

Editor's note

SEBI has been consistently following a consultative approach in formulating regulations for InvITs as well as for REITs in India. The release of this consultation paper is another step in this direction, as SEBI sought stakeholder comments before finalising guidance on disclosures in offer documents/ placement memoranda and valuation aspects for InvITs.

Indian securities market regulator releases discussion paper on algorithmic trading and co-location

Discussion paper by SEBI on algorithmic trading

Advances in technology have led to extensive use of computer-aided, high-speed trading globally, popularly known as algorithmic trading (algo trading). In India, algo trading accounts for more than 80 percent of the orders placed and approximately 40 percent of the trades.

While this ultra-high-speed, latency-sensitive algo trading model may offer several advantages, it also poses some risks to the financial system.

The Indian securities market regulator, SEBI has recently released a discussion paper on "Strengthening of the regulatory framework for algo trading and co-location."

The objective of the paper is to seek public comments and address concerns relating to market quality, market integrity and fairness due to increased usage of algo trading and co-location in the Indian securities market.

The key proposals mentioned in the discussion paper are introduction of minimum resting time for orders, frequent batch auctions, random speed bumps or delays in order processing/ matching, randomisation of orders received during a period, maximum order message-to-trade ratio requirement, separate queue for co-location orders and non-co-location orders, and review of tick-by-tick data feed.

- *Minimum resting time for orders*

It is proposed to introduce a minimum resting time for orders. Resting time refers to the time allowed by the exchange to modify/ amend/ cancel the order after it is received by the stock exchange.

As per the minimum resting time mechanism, the orders received by the stock exchange would not be allowed to be amended or cancelled before a specified amount of time, *viz.* 500 milliseconds, has elapsed.

- *Frequent batch auctions*

Currently, a continuous matching system is followed by Indian exchanges. It is proposed to introduce a frequent batch auctions mechanism, which tries to address the problem of "latency advantage," by setting up a time interval for matching orders that is short enough to allow for opportunities for intra-day price discovery but long enough to minimise the latency advantage.

Under the frequent batch auctions mechanism, buy and sell orders on the order book would be accumulated for a particular length of time (say 100 milliseconds). At the end of every such period, the exchange would match the orders received during the time interval.

- *Random speed bumps or delays in order processing/ matching*

It is proposed to introduce a speed bump mechanism, which would result in a randomised order processing delay of a few milliseconds.

The expected impact of this mechanism is to discourage latency-sensitive strategies, as such delays would affect

High Frequency Trading (HFT) but would not deter non-algo order flow, for which a delay of milliseconds is insignificant.

- *Randomisation of orders received during a period (say 1–2 seconds)*

It is proposed to introduce a mechanism for the randomisation of orders whereby the time-priority of new/ modified orders received during a pre-defined time period (say, a period of 1–2 seconds) will be randomised. Thereafter, a revised queue of orders with a new time priority will be forwarded to the order-matching engine of the stock exchange.

The intention of this mechanism is to discourage or nullify latency-sensitive strategies.

- *Maximum order-to-trade ratio requirement*

It is proposed to introduce a maximum order-to-trade ratio requirement. This mechanism requires market participants to execute at least one trade for a set number of order messages sent to a trading venue. It is expected to increase the likelihood of a viewed quote being available to trade and reduce hyperactive order-book participation.

The maximum order-to-trade ratio requirement is slightly different from the "order-to-trade penalty" rule, implemented by the stock exchanges in India. The trader, under the proposed maximum order-to-trade requirement rule, would not be able to place such orders that further increase the ratio, after the limit is breached.

- *Separate queue for co-located (colo) traders and non-co-located (non-colo) traders*

It is proposed to introduce a mechanism whereby separate queues and order-validation processes would be maintained for colo orders and non-colo orders.

Orders from queues will be taken up in the order book in a round-robin fashion (i.e. if an order is taken from the queue of orders emanating from a co-location/ proximity hosting facility, then the next order shall be from the other queue).

The proposed mechanism may, however, still provide colo traders the ability to react to market data due to their proximity to the trading platform of the exchanges.

- *Review of tick-by tick data*

At present, the tick-by-tick data feed is mainly subscribed to by HFTs who, coupled with their access to co-location, use such feeds to re-create the order book and analyse the impact of execution. It is not usually availed by small players, because of the data heaviness of the feed and additional fees.

It is proposed to provide "structured data" containing Top 20/ Top 30/ Top 50 bids/ asks, market depth, etc., to all market participants at a prescribed time interval (or as a real-time feed).

Editor's note

This move by SEBI is aimed to allay fears and concerns of unfair and inequitable access to the trading systems of the exchanges. The proposals of SEBI are primarily focused on discouraging latency-sensitive strategies. These proposals, if implemented, could dent liquidity in Indian capital markets and widen the bid-ask spreads, which may eventually defeat the purpose of algo trading. Nevertheless, the consultative approach adopted by SEBI in formulating regulations is a step in the right direction.

Tax treaty

Protocol for amendment of India-Mauritius tax treaty signed

Notification dated 10 August, 2016

The treaty between India and Mauritius was signed in 1982 and was in force from 01 April, 1983. As per the treaty, India did not have the right to tax capital gains arising to a Mauritius tax resident on the sale of shares of Indian companies. This, coupled with the fact that Mauritius did not levy a capital gains tax, had made Mauritius a favourable jurisdiction for investing into India.

Several tax disputes have arisen on the issue of availability of treaty benefits relating to capital gains, as the Indian tax authorities have sought to deny the benefits on the grounds of "treaty shopping." However, the Courts have mostly not accepted the contentions of the tax authorities.

The Indian Government has been negotiating a revision of the treaty with the Mauritius government for a long time. The Protocol is a result of the negotiations.

The following are the provisions of the Protocol, as seen from the perspective of the taxability in India of the income of a resident of Mauritius:

Taxation of capital gains

- In the case of shares in Indian companies acquired prior to 01 April, 2017, gains arising to a Mauritius resident on the transfer of such shares will continue to be exempt from tax in India, regardless of when the shares are transferred. In other words, gains from the transfer of shares acquired before 01 April, 2017, will not be taxable in India even if the shares are transferred on or after 01 April, 2017.
- India will have the right to tax capital gains arising from the sale of shares in an Indian company if such shares have been acquired on or after 01 April, 2017.
- As per the current provisions of the treaty, gains arising to a Mauritius resident from the alienation of immovable property, of movable property associated with a permanent establishment, and of ships and aircrafts operating in international traffic and associated movable property can already be taxed in India in certain cases.
- Gains arising to a resident of Mauritius from the alienation of any other property can be taxed only in Mauritius.

Lower capital gains tax rate

- There is a lower tax rate applicable to shares acquired on or after 01 April, 2017, if such shares are sold before 01 April, 2019. In such cases, the gains would be taxable in India as per the Indian tax laws, but the rate of tax will be equal to 50 percent of the applicable tax rate for such capital gains.
- The benefit of the lower tax rate on capital gains would be available to a Mauritius tax resident (“the alienator”) only if
  - (a) The affairs of the alienator are not arranged with the primary purpose of taking advantage of the benefit of the lower rate;
  - (b) The alienator passes a “main purpose” test and a “*bona fide* business” test; and
  - (c) The alienator is not a shell/ conduit company.
- Companies not having a *bona fide* business activity are treated as if their affairs were arranged with the primary purpose of taking advantage of the benefit of the lower rate.
- A shell/ conduit company means any entity with negligible or Nil business operations, or with no real and continuous business activities carried in Mauritius.
- A Mauritius resident company whose expenditure on operations is less than Mauritian Rupees 1.5 million during the period of 12 months preceding the date the gains arise is deemed to be a shell/ conduit company.
- However, a Mauritius resident company shall be deemed not to be a shell/ conduit company, if
  - (a) it is listed on a recognised stock exchange in Mauritius; or
  - (b) its expenditure on operations in Mauritius is equal to or more than Mauritius Rupees 1.5 million during the period of 12 months preceding the date the gains arise.
- In the case of shares in an Indian company acquired on or after 01 April, 2017, and transferred on or after 01 April, 2019, the gains arising on the transfer will be taxed as per Indian tax laws without any concession.

Interest income

- Interest arising in India and paid to a resident of Mauritius may be taxed in India, but the tax cannot exceed 7.5% of the gross amount of interest if the beneficial owner of the interest is a resident of Mauritius. It may be noted that prior to the Protocol, interest arising in India and paid to a resident of Mauritius (other than a bank) was taxable in India at a rate that could be as high as 40% (excluding surcharge and cess).
- The earlier exemption for interest income of a bank resident in Mauritius carrying on *bona fide* banking business continues in respect of the interest arising from debt claims existing on 31 March, 2017.

Other changes

- The Protocol has introduced a provision relating to taxation of FTS, largely on similar lines as in various other treaties entered into by India.

- FTS arising in India and paid to a resident of Mauritius may be taxed in India, but the tax cannot exceed 10% of the gross amount of FTS, if the beneficial owner of the FTS is a resident of Mauritius.
- As per the treaty, income not expressly dealt with by any other provision of the treaty is taxable in the country of residence of the recipient of income. The Protocol has amended the treaty to provide that such income may also be taxed in the country in which the income arises. In other words, any income arising in India to a Mauritius resident would be subject to tax in India, unless it is expressly dealt with by a specific provision of the treaty.
- The Protocol has widened the scope of the term “permanent establishment” to include the activity of furnishing services, including consultancy services. Such activities would constitute a permanent establishment if the activities continue for a project (or two or more related projects) for a period aggregating to more than 90 days within any 12-month period.
- The Protocol modifies the existing provisions in the treaty relating to the exchange of information and assistance in tax collection.

Effective date

- The Protocol will apply from AY 2018-19 for all purposes except for the provisions relating to exchange of information and tax collection, which will come into effect immediately.

Editor’s note

- *Going forward, there would be a tax on capital gains arising to a Mauritius company on the transfer of shares of companies resident in India.*
- *It should be noted that gains arising on transfer of shares of companies that are not resident in India should continue to not be taxable in India. Similarly, gains from the alienation of debt instruments should also continue to not be taxable in India.*
- *Based on the Protocol, the India-Singapore treaty would be affected to the extent that it provides that capital gains may be taxed only in the country of residence, as the relevant provisions have been linked to the continuation of the corresponding provisions of the India Mauritius treaty. In this respect, a senior official of the Government of India has stated that the Indian government intends to re-negotiate the treaty with Singapore to bring it on par with the India-Mauritius treaty.*
- *Earlier, Mauritius was not a preferred jurisdiction for making loans or debt investments as compared with other countries, except to the extent of loans from a Mauritius resident bank. The change in the tax rate to 7.5% on interest income should provide Mauritius a competitive edge over other countries.*
- *Going forward, FTS arising in India earned by a Mauritius resident should ordinarily be taxable in India, but the rate should not exceed 10% if certain conditions are satisfied.*

Double taxation avoidance agreement between India and Cyprus revised

In July 2016, the GoI *vide* a press release had announced that negotiation on the tax treaty between India and Cyprus had been completed and that the necessary procedures to amend the tax treaty had been initiated. Marking a culmination of the said negotiations, the GoI and the Government of Cyprus (GoC), on 18 November, 2016, signed a protocol amending the provisions of the tax treaty between India and Cyprus. The GoI issued a press release dated 18 November, 2016 (press release) providing a gist of the key amendments. The fine print of the revised India-Cyprus tax treaty is awaited.

Further, the press release issued by the GoC on 18 November, 2016 provides that Cyprus will not be regarded as an NJA under the Act retrospectively from 01 November, 2013. The GoI had indicated such a rescindment in its press releases issued on 01 July, 2016.

The key amendments to the India-Cyprus tax treaty, as summarised in the press release, are as follows:

- Source-based taxation of capital gains arising from alienation (disposal) of shares. In other words, India shall have the right to tax capital gains arising to Cyprus tax residents on the transfer of shares of an Indian company;
- Grandfathering of investments undertaken prior to 01 April, 2017;
- Expanding the scope of the term ‘PE’, possibly to introduce the concept of service PE;

- Aligning the rate of tax for royalty under the India-Cyprus tax treaty with the rate under the Act, by reducing it to 10%;
- Assistance between India and Cyprus for collection of taxes;
- Updating the provisions related to exchange of information as per international standards, which will enable exchange of banking information and allow the use of such information for purposes other than taxation (subject to prior approval of competent authorities); and
- Updating other provisions of the India-Cyprus tax treaty in accordance with international standards and India's policy with respect to tax treaties.

Editor's note

The signing of the revised India-Cyprus tax treaty is a welcome step. One would hope that the GoI quickly notifies the rescindment of the notification considering Cyprus as an NJA, which resulted in mandatory levy of withholding tax and applicability of Indian transfer pricing provisions to transactions with Cypriot residents.

While the press release mentions key amendments, one will have to wait for the fine print of the protocol to examine if there are other amendments to the India-Cyprus tax treaty.

PS: As we close the issue, news has come in that the Government has rescinded 2013 notification issued under section 94A treating Cyprus as a non-cooperative jurisdiction.

Withholding tax

CBDT clarifies that no tax is required to be deducted at source under section 194-I on lease premium paid for acquisition of long-term leasehold rights

CBDT Circular No. 35 of 2016 dated 13 October, 2016

Background

Section 194-I of the Act requires deduction of tax at source on payment of rental income. Currently, tax is required to be deducted at source at the rate of 10 percent on rent payable for use of land or building.

Rent is defined under the provisions of the aforesaid section to mean any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of land or building or machinery or plant or equipment or furniture or fittings.

Traditionally, the question pertaining to the inclusion of lease premium paid for the acquisition of long-term leasehold rights in the aforesaid definition of "rent," and consequently, the requirement to deduct tax at source under the provisions of section 194-I of the Act, has been a subject matter of litigation. The Delhi HC and the Chennai HC, in the cases of Indian Newspaper Society *v.* ITO ITA No. 918 and 920/ 2015 (Delhi), Foxconn India Developer (Private) Limited *v.* ITO Appeal No. 801/ 2013 (Chennai) and Tril Infopark Limited *v.* ITO Appeal No. 882/ 2015 (Chennai) have held that no tax is required to be deducted at source under section 194-I of the Act on payment of lease premium/ upfront charges paid for acquisition of leasehold rights. The Revenue has accepted the decisions of the HCs and has not filed a special leave petition in the SC.

CBDT clarification

In view of the settled position, the CBDT has clarified that lumpsum lease premium or one-time upfront lease charges, which are not adjustable against periodic rent paid or payable for acquisition of long-term leasehold rights over land or any other property, are not payments in the nature of rent within the meaning of section 194-I of the Act. Hence, no tax is required to be deducted at source under the provisions of section 194-I of the Act on such payments.

Capital gains

CBDT clarifies in relation to characterisation of income/ loss arising from transfer of listed and unlisted shares

Circular No. 6/ 2019 dated 29 February, 2016

The CBDT has clarified the issue of taxability of gains arising on sale of listed shares and securities. The circular lays down guiding principles to characterise the gains from sale of listed shares and securities as either business income or capital gains. The CBDT has clarified that where the taxpayer itself treats listed shares and securities as 'stock-in-trade' regardless of the period of holding, the said income would be considered under the head, 'Income from business and profession'. It has further clarified that the TO

would not dispute any income arising from the transfer of listed shares and securities held for more than 12 months, if the same was treated as, and offered to tax under, the head, 'capital gains', subject to the genuineness of the transaction being established. However, this stand, once taken in a particular year, shall not be allowed to be changed in the subsequent years.

Editor's note

This CBDT circular provides relief to taxpayers dealing with issues with respect to characterisation of income on sale of listed shares and securities.

Circular No. F. No. 225/ 12/ 2016/ ITA.II dated 2 May, 2016

On 2 May, 2016, the CBDT issued another instruction to the tax department on determining the tax treatment of income arising from transfer of unlisted shares to avoid disputes/ litigation, and to have a consistent view in assessments. It was clarified that the income arising from transfer of unlisted shares has to be considered as 'capital gain', irrespective of its holding period, to avoid disputes/ litigation, and to maintain a uniform approach. However, the CBDT has carved out the following three exceptions for the TO to take an appropriate view, if -

1. the genuineness of transactions in unlisted shares itself is questionable; or
2. the transfer of unlisted shares is related to an issue pertaining to the lifting of the corporate veil; or
3. the transfer of unlisted shares is made along with the control and management of underlying business.

Editor's note

Although the instruction is with a view to provide clarity on taxability of gains arising from the transfer of unlisted shares, the third exception on transfer of unlisted shares along with the control and management of underlying business could result in increased litigation. While the instruction is positive for the investor fraternity (PEs, AIFs, etc.), it could invite challenges in assessments for strategic divestments.

FPI investments

FPIs permitted to invest in unlisted NCDs

Notification No. FEMA 374/ 2016 –RB

The finance minister stated in his 2016 budget speech, "*Investment basket of foreign portfolio investors will be expanded to include unlisted debt securities and pass through securities issued by securitisation SPVs.*"

In the light of the above, the RBI issued a notification on 24 October, 2016, providing for the following amendments:

- RFPIs are now permitted to invest in unlisted NCDs issued by Indian companies. Earlier, investment by RFPIs was permitted only in listed or to be listed NCDs of an Indian company, except those engaged in the infrastructure sector, which could issue unlisted NCDs.
- RFPIs are now also permitted to invest in securitised debt instruments including (i) any certificate or instrument issued by a SPV set up for securitisation of assets with banks, FIs or NBFCs as originators, and/ or (ii) any certificate or instrument issued and listed in terms of the SEBI's Regulations on Public Offer and Listing of Securitised Debt Instruments 2008.

Key amendments made through the Finance Act, 2016

MAT

Clarification regarding MAT provisions not applicable to foreign companies

Clarification has been provided regarding MAT provisions not being applicable to a foreign company (foreign investors under the FDI or FPI route), with retrospective effect from FY 2001–2002, if:

- it is resident of a country with which India has a tax treaty, and it does not have a PE in India, in accordance with the provisions of the relevant tax treaty; or
- it is resident of a country with which India does not have a tax treaty, and it is not required to seek registration under Indian corporate laws.

This has been introduced in line with the recommendation of Justice A.P. Shah

Committee that MAT should not apply to corporate FPIs, with retrospective effect from 01 April, 2001.

Capital gains

Holding period of unlisted shares to be considered as long-term brought down to 24 months

In case of unlisted shares, the period of holding for transfer to be considered as a short-term capital asset has been reduced from 36 months to 24 months.

Originally, the period of holding of shares in a company for determination of whether the capital gains were long-term or short-term, was 12 months. However, this period was extended to 36 months in the case of unlisted companies by the Finance Act (No. 2) of 2014, which was considered by many as a retrograde step.

The current reduction in the period of holding for unlisted companies from 36 months to 24 months is a welcome change.

Withholding tax

Withholding tax on amount payable by investment funds to unitholders

Prior to the amendment by the Finance Act, 2016, an AIF was required to withhold taxes on payment made to any investor (whether resident or non-resident) of any non-business income at the rate of 10%.

The Finance Act, 2016 has amended section 194LBB of the Act to provide that if a payee is a non-company, non-resident or a foreign company, no tax will be withheld on income on which no tax is chargeable (for instance, in case of tax treaty benefit being availed, or receipt of dividend).

While tax withholding from distributions made to non-resident investors shall be made at rates in force (including rates applicable on account of a tax treaty), resident investors continue to suffer a 10% withholding tax rate on gross distributions made by such AIFs, including distributions of exempt income such as dividend.

Notifications and circulars

- Income-tax
- India social security
- Immigration

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Personal tax

Notifications and circulars

Income-tax

Indian government proposes to introduce new income disclosure scheme post-demonetisation

On 28 November, 2016, the Finance Minister of India introduced the Taxation Laws (Second Amendment) Bill 2016 in the Lower House of Parliament, and proposed another Income Disclosure Scheme (the Pradhan Mantri Garib Kalyan Yojna 2016) to declare undisclosed income in the form of cash or deposit in an account maintained by a person with a specified entity. The scheme shall be implemented with effect from a date to be notified by the Government.Under the proposed scheme, a person can clear up past transgressions by paying a total of 49.9 percent of the income disclosed under the Scheme (30 percent tax, 33 percent of the tax as Pradhan Mantri Garib Kalyan Cess and 10 percent of the income disclosed as penalty). Further, at least 25 percent of the undisclosed income has to be deposited in a specified deposit scheme (the Pradhan Mantri Garib Kalyan Deposit Scheme, 2016) with a lock-in period of four years, bearing no interest.

The Government has also proposed amendments in the existing provisions of the Act related to tax on unexplained cash credits, investments, money, expenditure etc., and introduced higher tax rates and penalties to deal with such cases. In case the taxpayer does not avail the last opportunity provided under the proposed Scheme, the other related provisions of the Act will be applicable, subject to the proposed amendments, as tabulated below:

Particulars	Existing provisions	Proposed provisions
Amendment in section 115BBE (Tax on income in respect of unexplained cash credit/ income, investment, expenditure etc.)	Tax @ 30% payable	Tax @ 60% plus surcharge @ 25% (effective tax rate will be 75%)
Insertion of new section 271AAC (Penalty on unexplained cash credit/ investment/ money/ expenses etc. as provided under section 115BBE)	Not applicable	Penalty @10% levied where tax authorities determine income under section 115BBE. However, no such penalty shall be levied in case income has been reported in the Return of Income and accepted by the tax authorities and if required tax has been paid before end of relevant previous year.
Amendment in section 271AAB related to Search & Seizure cases # (increase in the rate of penalty)	1. 10% of the undisclosed income if the income is admitted, required tax has been paid and return of income has been filed. 2. 20% of the undisclosed income if the income is not admitted but required tax has been paid and return of income has been filed. 3. 30% to 90% of the undisclosed income in all other cases.	1. 30% of the undisclosed income, if the income is admitted, required tax has been paid, and return of income has been filed. 2. 60% for all other cases.

To be applicable once the proposed amendment gets Presidential assent.

Note: The proposed amendments shall be effective from 01 April, 2017 (i.e. AY 2017-18)

Editor's note

The proposed scheme provides yet another opportunity to those who missed during the earlier window, to come clean by paying tax, cess and penalty of 49.9 percent and by keeping 25 percent of the undisclosed income in the specified interest-free deposit scheme. Earlier, the government came out with the Income Declaration Scheme, 2016 (already closed on 30 September, 2016) wherein those having domestic undisclosed income were provided an opportunity to come clean by paying 45 percent of tax and penalty on such undisclosed income. Simultaneously, the existing provisions relating to levy of tax and penalty have also been proposed to be amend, whereby such undisclosed income would get taxed at a significant higher rate of 75 percent to deter the accumulation of black money.

Two more modes of generating EVC for paperless return filing notified

Notification No. 01/ 2016 dated 19 January, 2016

Earlier, taxpayers were using either a digital signature or an EVC to file paperless income tax returns in India. The EVC can be generated by using the Aadhaar Number, net banking, ATMs, or the registered email and mobile number of a taxpayer.

To include more taxpayers in the EVC process, the CBDT has issued a notification including the bank account and the Demat account as two additional modes of generating the EVC for filing paperless income tax returns.

Editor's note

Bank account or Demat account-based EVC generation is a welcome step, as it will make it simpler for taxpayers to file paperless returns.

Government issues procedures for e-hearing for paperless assessments

Notification No. 02/ 2016 dated 03 February, 2016

In 2015, the CBDT initiated the concept of using email-based communication for paperless scrutiny proceedings. It was decided to launch a pilot project, comprising non-corporate taxpayers in five cities, namely, Delhi, Mumbai, Bengaluru, Ahmedabad and Chennai. Initially 100 taxpayers will be identified in each of these cities from the cases that have been selected for scrutiny based on the AIR/ CIB information or form 26AS mismatch. With the consent of these selected taxpayers, tax officials would conduct e-hearings through their official email IDs with the taxpayers, at the email IDs as provided by them in their tax returns.

In this regard, the CBDT has notified the procedures and standards to ensure secured transmission of electronic communication.

Editor's note

It is a welcome initiative taken by the government and will help in the speedy completion of scrutiny assessment. It will also save the time and effort of visiting tax offices every time a proceeding takes place.

Government notifies new income tax return forms for FY 2015-16

Notification No. 24/ 2016, dated 30 March, 2016

The CBDT has notified income-tax return forms applicable for the FY 2015-16 (AY 2016-17). There are no major changes in the forms compared to FY 2014-15.

The key amendments in the forms pertaining to individual taxpayers are briefly summarised below:

- Taxpayers having total income exceeding INR5 million need to declare their assets and liabilities.
- Taxpayers need to report details of pass-through income received from business trusts or/ and investment funds in a separate schedule.
- Schedule–ICDS has been introduced in Form 4 to disclose the effect of ICDS on profit.
- Taxpayers filing Form 1, 2 and 2A will now be able to claim credit for TCS.

Detailed changes in the notified return forms are as follows -

Changes introduced/ scope enlarged	Reference in return forms	Applicable ITR form(s)	Remarks
Details of assets and liabilities held as on 31 March, 2016	Schedule – AL	ITR – 1, 2, 2A 3, 4 and 4S	Taxpayers having income exceeding INR5 million are required to disclose their movable and immovable assets at cost. Assets which are required to be disclosed are • Land • Building • Cash in hand • Jewellery, bullion, etc. • Vehicles, yachts, boats and aircraft • Liability in relation to above assets. Forms 3 and 4 already have Schedule–AL and those having income more than INR2.5 million are required to disclose non-business assets. The scope of 'specified asset' is also very large and includes even financial assets and archaeological collections, paintings, sculptures, etc. There is no change in Schedule-AL, except that the threshold limit of applicability has been raised from INR2.5 million to INR5 million.

Changes introduced/ scope enlarged	Reference in return forms	Applicable ITR form(s)	Remarks
Details of pass-through income received from business trust or/ and investment fund	Schedule-PTI	ITR – 2, 2A, 3 and 4	Sections 115UA and 115UB of the Income-tax Act, 1961 were introduced recently, wherein it has been provided that any distribution of income by a business trust/ investment fund to its unit holders shall be deemed to be income of the same nature, and taxed in the same proportion in their hands as it has been received or accrued to the business trust/ investment fund. Schedule-PTI has been introduced to capture the relevant information and details asked for are as below: • Name of business trust/ investment fund • PAN of business trust/ investment fund • Head of income • Amount of income • Taxes withheld, if any.
Details of TCS	Schedule-TCS	ITR-1, 2 and 2A	Currently, sellers are required to collect tax at source in certain transactions such as buying jewellery in cash exceeding INR0.5 million. There was no column provided in the forms prescribed for earlier years, which made it difficult to claim credit for TCS in the return form. Schedule-TCS will enable taxpayers to claim the credit for TCS in their returns. The following details need to be provided in the schedule • Tax collection account number of the collector • Name of the collector • Tax collected • Amount out of tax collected being claimed
Effect of ICDS on profit	Schedule – ICDS	ITR – 4	This schedule has been introduced to disclose the impact of recently notified ICDS on business profits.

Editor's note

With the abolition of wealth tax, it was expected that some sort of disclosure of assets in the return form would be introduced. Foreign nationals working in India are also required to report their assets, if their income exceeds INR0.5 million.

CBDT notifies a new form for reporting employee claims and tax saving investments, amends withholding tax rules and forms

Notification No. 30/ 2016, dated 29 April, 2016

The CBDT has come out with the relevant rules and also prescribed a form, Form 12BB, in which salaried employees would be required to furnish evidence of claims and tax-saving investments to the employer.

Other amendments that have been made in the withholding tax provisions are summarised below:

- The time limit for depositing tax under section 194-IA of the Act (on transfer of immovable property) has been extended from 7 days to 30 days.
- The due dates for filing the quarterly withholding tax statements (Forms 24Q, 26Q and 27Q) have been extended by 15 days.
- In case of house rent allowance exemption claim and deduction of interest under the head income from house property, the details of the landlord and lender, respectively, would be required to be mentioned in the salary withholding tax statement (Form 24Q).

These amended rules are applicable from 01 June, 2016.

Editor's note

Notification of the form and the relevant rules for collecting investment proofs, etc., were much awaited and are welcome steps. Employers should ensure that they collect and maintain robust documentation in terms of proof/ evidence for LTA and other deductions for tax saving investments to avoid any possible questioning by tax authorities in the near future.

Government notifies Income Declaration Scheme, 2016 and issues valuation rules and FAQs

Notification No. S. O. 1831(E) dated 19 May, 2016

As announced in the Union Budget for the FY 2016-17, the Income Declaration Scheme, 2016 (the Scheme) was introduced as Chapter IX of the Finance Act, 2016.

The key features of the scheme are summarised as under:

- The Scheme was effective from 01 June, 2016 for a period of four months (i.e. till 30 September, 2016).
- Taxpayers were given an opportunity to declare their undisclosed income whether in the form of investment in assets in India or otherwise, and to clear up their past tax transgressions by paying a total of 45 percent (tax at 30%, Krishi Kalyan Cess at 7.5% and penalty at 7.5%) of the undisclosed income.
- No scrutiny or inquiry would be undertaken in respect of such declarations, where applicable tax and penalty were paid.
- Declarants would be provided immunity from penalty/ prosecution proceedings under the Act or/ and the Wealth-tax Act, 1957 (the Wealth-tax Act) and Benami Transaction (Prohibition) Act, 1988 subject to certain conditions.
- No declaration could be made in respect of any undisclosed income chargeable to tax under the Act for AY 2016-17 or any earlier AY in the following cases:
  - where a scrutiny or search and seizure assessment was pending at the time of declaration
  - in relation to any undisclosed foreign income and asset that is chargeable to tax under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015

The CBDT had also notified the Income Declaration Scheme Rules, 2016, and issued explanatory notes along with clarifications in the form of FAQs for better compliance with the scheme.

Editor's note

The Scheme provided a one-time opportunity to declarants to come clean by paying 45 percent (as tax, cess and penalty) to the government.

India social security

EPFO releases consolidated guidelines on PF compliances in respect of outbound assignees

Notification No. IWU/ 7(49)2013/ Appointments/ 36602

The EPFO has released the consolidated guidelines to be uniformly applied by the various PF field offices across the country for securing compliances with regard to Indian outbound employees proceeding to work in a foreign country.

The set of guidelines applicable to SSA and non-SSA countries have been summarised below.

Country	Whether on Certificate of Coverage (CoC)	Compliance with during foreign deputation		Remarks
SSA	Yes	Compliance with EPFO	EPFO compliance to continue during the detachment period. The reported compliance should be same as was being reported immediately before the detached employee proceeds to the other country.	This deals with Indian outbound employees going to a foreign country with which India has signed an SSA and CoC has been obtained for claiming exemption from contributing to the host country's social security system. The clarification provides that the PF contribution shall be required to be made on the same salary that was paid immediately before the employee proceeded to the foreign country.
		Compliance with the social security system of host country	Exempted from enrolment on production of CoC for the duration indicated in the CoC.	
SSA	No	Compliance with EPFO	Employer will be required to report compliance if any Indian salary is payable or paid during this period.	This deals with Indian outbound employees working or going to work in a foreign country with which India has signed a SSA, but does not hold a CoC. The employee is liable to contribute to the host country's social security system. As per the FAQs released in November 2012, the contribution shall be payable on the total salary payable by the Indian establishment, even for responsibility outside India. It has been clarified that the employer shall be required to make PF contribution and undertake compliance only if any Indian salary is paid or payable by the Indian establishment.
		Compliance with the social security system of the host country	Employee to be governed as per the law of the host country.	

Country	Whether on Certificate of Coverage (CoC)	Compliance with during foreign deputation		Remarks
Non-SSA	No	Compliance with EPFO	Employer will be required to report compliance if any Indian salary is payable or paid during this period.	This deals with Indian outbound employees going to a foreign country with which India does not have an SSA, hence they are liable to contribute to the host country's social security system. It is clarified that the employer shall be required to make PF contribution and undertake compliance only if any Indian salary is paid or payable by the Indian establishment.
		Compliance with the social security system of the host country	Employee to be governed as per the law of the host country.	

Editor's note

Companies are advised to review their compensation structure for outbound assignments and ensure that they are carrying out the Indian social security obligations on the right salary and also in the manner as clarified above.

EPFO notifies the date of entry into force of the social security agreement with Australia and Japan

File No. IWU/ 7(2)2009/ Australia/ Vol-I/ 24955 dated 16 March, 2016

Ministry of External Affairs, Government of India, press release dated 20 July, 2016.

The EPFO has notified the date of entry into force of the SSA entered with Australia and Japan. The SSA with Australia and Japan will be operational from 01 January, 2016 and 01 October, 2016, respectively.

Editor's note

It will facilitate the movement of employees between India and Australia/ Japan by eliminating double contribution and/ or providing the benefit of exportability and totalisation of period for determining eligibility for pension benefits. India now has 17 agreements that have become operational, and an agreement with Portugal is also expected to come into force in the near future.

Members of employees' pension scheme will get extra benefit if they opt to defer withdrawal

Notification No. GSR 440(E) dated 25 April, 2016

The Ministry of Labour and Employment (MLE) has amended the Employees' Pension Scheme 1995 (the Scheme) and provided a beneficial option to their members. Post amendment, members of the Scheme can opt to defer their withdrawal of pension amount by a maximum period of up to two years after attaining the age of 58, and get an extra benefit of 4 percent per annum on compounding basis. Further, such members may also be allowed to continue contributing to their pension fund if their employment continues after 58 years of age.

The key amendments are summarised below:

- The amendment is applicable to members who attain the age of 58 on or after 25 April, 2016, and are eligible for pension under the Scheme. However, this benefit is not available to existing pensioners.
- All members of the Scheme who have completed pensionable service under the Scheme (at least 10 years of service) can opt for deferment of the pension for a maximum period of two years on attaining the age of 58.
- To avail the option, the eligible member needs to file a request letter with the field office within a specified time limit to be prescribed by the pension division head office by exercising the claim form.
- Members may also be allowed to contribute to the fund during the period for which the withdrawal has been deferred, provided they continue in employment after attaining the age of 58.
- Where an eligible member opts to defer the withdrawal, the pension amount will be increased by a compounding rate of 4% for each completed year of deferment.
- Pensionable service and salary will be calculated after taking into consideration the

period for which contributions were made beyond 58 years of age. However, this will not be considered for determining eligibility.

Editor's note

With the increase in life expectancy, this amendment is a welcome step by the government, as members will now have an option to contribute to, and defer their pension for another two years.

Government of India excludes Nepalese and Bhutanese nationals from the special category of international workers

Notification no. GSR 1036(E) dated 02 November, 2016

The Ministry of Labour and Employment (MLE) has provided that workers who are Nepalese nationals (on account of Treaty of Peace and Friendship of 1950) or Bhutanese nationals (on account of India-Bhutan Friendship Treaty of 2007) would not qualify as IW, and would be treated as Indian workers.

Editor's note

The notification is a welcome move by the MLE, which will benefit Nepalese/ Bhutanese nationals on cross-border assignments to India, as they would be treated as Indian workers, and would remain outside the purview of the special PF and pension provisions applicable to foreign nationals who qualify as IW in India.

Amendment in provisions relating to inoperative accounts

Notification no. GSR 1065(E) dated 11 November, 2016

The EPFO has recently amended the Employees Provident Fund Scheme, 1952 (EPF Scheme) relating to provisions of inoperative accounts. As per the amended provisions, cases of cessation of employment have now been excluded from the ambit of 'inoperative account'. Accordingly, the PF accounts of such members would not be designated as 'inoperative' if they cease to be employees of covered establishments, and fail to either file an application of withdrawal, or transfer the accumulated balance into a new account with another employer, within a period of 36 months.

The position after this amendment has been tabulated as below.

Situation	Position before the amendment	Effect after amendment
The member migrates abroad permanently and does not apply for withdrawal or transfer within a period of 36 months from such date.	The account will be designated as inoperative after a period of 36 months, and will cease earning any interest from such date.	No change
Where the member retires from service after attaining the age of 55 and does not apply for withdrawal or transfer within a period of 36 months from the date of retirement.	The account will be designated as inoperative after a period of 36 months, and will cease earning any interest from such date.	No change
Where the member ceases to be in employment and does not apply for withdrawal or transfer within a period of 36 months from the date of retirement.	The account will be designated as inoperative after a period of 36 months, and will cease earning any interest from such date.	The account will not be designated as inoperative, and will continue to earn interest.
Where the member dies and no application for withdrawal or transfer has been made within a period of 36 months from such date.	The account will be designated as inoperative after a period of 36 months, and will cease earning any interest from such date.	No change
Where the amount becoming due to a member as a result of supplementary contributions on account of litigation or default of establishment or a claim settled is received undelivered, not attributable to the member.	No clarity on the matter	Clarification through new proviso provided that such amount will not be transferred to an inoperative account and continue to earn interest.

Editor's note

Since the provisions related to 'inoperative accounts' are not applicable to IWs, their position will not change due to the above amendment. International workers will continue to earn interest on their PF account, even if their contribution is stopped due to cessation of employment, etc.

Immigration

Scheme for grant of PRS to foreign investors

Press Information Bureau release dated 31 August, 2016

The Union Cabinet has approved a scheme for the grant of Permanent Residency Status (PRS) to foreign investors subject to specified conditions. The PRS will serve as a multiple entry visa without any stay stipulation, and will provide exemption from FRRO registration.

The key features of the PRS scheme are summarised below:

- The foreign investor will invest a minimum of INR100 million, which would need to be brought into India within 18 months, or INR250 million, to be brought in within 36 months.
- The foreign investment should generate employment for at least 20 resident Indians every financial year.
- The PRS will be granted for an initial period of 10 years, which may be renewed for another 10 years, subject to good conduct of the PRS holder.
- The PRS holders will be allowed to purchase one residential property for dwelling purposes.
- The spouse/ dependents of the PRS holder will be allowed to take up employment in the private sector in relaxation of salary stipulations for employment visa (which is presently capped at $25,000 per annum) and undertake studies in India.
- Suitable provisions will be incorporated in the visa manual to provide for the grant of PRS to foreign investors.

Editor's note

The PRS scheme is yet another welcome step to strengthen the "Make in India" program and will encourage more inward foreign investment. It will help in ease of doing business in India.

Case law

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Mergers & Acquisitions

Case law

Unabsorbed losses

Carry-forward and set-off of unabsorbed losses not permissible on change in shareholding by over 49% even if transaction is intra-group

ITA 349/ 2015 and ITA 388/ 2015 (Delhi)

Taxpayer held not entitled to carry forward and set off unabsorbed losses on change in immediate shareholding by over 49%, even though the change in shareholding was within the group, and the ultimate holding company of both the transferor and transferee was the same.

Facts

The taxpayer was a wholly owned subsidiary of Company A and had unabsorbed tax losses. The shareholders of the Company A transferred their entire shareholding to another group company, Company B. Accordingly, the taxpayer's immediate shareholding changed wholly. However, the ultimate holding company of both companies was same. As per the provisions of the Act, a closely-held company cannot carry forward its unabsorbed losses for set-off against the income of succeeding years, if 51% of the voting power is not beneficially held by persons who beneficially held shares in the year in which the losses were incurred, i.e., where there is a change in beneficial shareholding by more than 49%. The TO disallowed the carry forward of losses as the taxpayer's immediate shareholding had changed by over 49%. The Tribunal disallowed the carry-forward and set-off of losses on the grounds that there was a change in the beneficial ownership of taxpayer's shares. The Tribunal held that Company A and Company B being subsidiaries of the ultimate holding company did not mean that there was no change in beneficial ownership.

Held

There was a change of ownership of 100% shares of the taxpayer company. There was no agreement or arrangement to show that the beneficial owner of such shares would be the ultimate holding company. Further, the question of "piercing the veil" in the instant case did not arise. Accordingly, the taxpayer was not permitted to carry forward and set off the unabsorbed losses of earlier years.

Editor's note

This ruling may be pertinent for group restructuring resulting in change in immediate shareholding of closely held company, with unabsorbed loss, by over 49%. Recently, the Karnataka HC [ITA No.766 OF 2009 c/ w ITA Nos.769/ 2009, 1046/ 2008, 765/ 2009 & 767/ 2009 (Karnataka)] has held that the carry-forward and set-off of unabsorbed losses is permissible even if shareholding changes by more than 49%, as long as there is no change in control. However, no reference to that case has been made in the present case.

Capital Gains

Buy-back under an HC-approved scheme not reorganisation within meaning of exception under Article 13(5) of India-Netherlands tax treaty

Accordis Beheer BV *v.* DIT [ITA No. 4688/ Mum/ 2010 and 5025/ Mum/ 2010 (Mumbai-Tribunal)]

Capital gains, arising to a non-resident taxpayer, on transfer of shares in an Indian company under a HC-approved buy-back scheme do not qualify as "reorganisation" referred to in Article 13(5) of the tax treaty between India and Netherlands. Article 13(5) provides that capital gains realised in the course of a corporate reorganisation shall not be taxable in India if the buyer or seller owns at least 10 percent of the other's capital.

Facts

The taxpayer held 38.24 percent shares in an Indian public listed company (the Company). The taxpayer tendered part of its holding to the Company under a scheme of buy-back approved by the Calcutta HC under section 391 of the Companies Act 1956 (the Scheme). As per Article 13(5) of the tax treaty, gains arising from the alienation of shares of an Indian company, in which its shareholding was more than 10 percent, would be taxable in India if the alienation was in favour of an Indian resident. However, the Article also provided an exception, that gains realised by a resident of Netherlands on alienation of shares in an Indian company,

would be taxable in Netherlands if they arose in the course of corporate organisation, reorganisation, amalgamation, division or similar transaction, and if either the buyer or the seller owned at least 10 percent of the capital of the other. The taxpayer claimed the gain on transfer of shares to be exempt from tax in India under this exception. The TO held that the exception was not applicable to the said transaction. The taxpayer did not pay tax in Netherlands, and contended that it was not necessary to pay tax in one country to claim treaty benefits in the other country.

Held

In view of the decisions relied upon by the taxpayer, the payment of tax in Netherlands was not an essential condition for availing treaty benefits in India. As the Scheme was approved by the HC, and as the case involved interpretation of the Article, there was no colourable device. As per the Dictionary of Accountants by Eric. L. Kohler, reorganisation should involve major change in the financial structure of a corporation, resulting in alteration in rights and interests of security holders. Buy-back of shares resulting in reduction in share capital, as in this case, could not be interpreted as a major change in the financial structure. This is because of the following:

- Security holders continued to enjoy the same types of rights and interests even after reduction of capital. There was no alteration in the rights and obligations of shareholders.
- The change in promoters' percentage of shareholding could not be considered a change in the rights and interests of the shareholders. Promoter groups continued to have the same rights and interests even after capital reduction.
- The reorganisation contemplated in section 390 of the Companies Act 1956 consists of either consolidation of shares of different classes, or division of shares into different classes, or both.
- The taxpayer's attempt to bring the transfer of shares within the ambit of the term, "reorganisation" was incorrect, since the objective of the arrangement was not financial restructuring, but providing exit to non-resident shareholders.
- Considering the above, transfer of shares pursuant to a buy-back scheme could not fall under the ambit of the term, "reorganisation."

The Scheme involved two activities, *viz.*, buying back of shares and cancellation of the shares that were bought back. The CIT(A) held that both the activities did not need to be clubbed.

On the second issue on applicable rate of tax, placing reliance on the ruling in the case of Cairn UK Holdings Limited [2013] 359 ITR 268 (Delhi) and Abbott Capital India Limited [2014] 65 SOT 121 (Mumbai-Tribunal), the issue was answered in favour of the taxpayer, holding that the capital gains were taxable at a concessional rate of 10%.

Editor's note

The Tribunal has held that changes in shareholding pattern pursuant to a scheme of buy-back cannot be construed as "reorganisation" within the exception prescribed in Article 13(5) of the tax treaty between India and Netherlands, on the premise that the shareholders' rights remain the same, in spite of change in shareholding.

Consideration for sale of rights in trademarks to be split between primary trademark and associate trademark while computing capital gains

Nirma Chemical Works Private Limited *v.* DCIT [ITA No. 1706/ Ahd/ 2009 (Ahmedabad-Tribunal)]

Associate trademarks were registered as separate trademarks, and accordingly, consideration received on transfer of trademarks (associate and primary trademark as a whole) should be allocated to the respective individual trademarks, and that capital gains had to be computed accordingly.

Facts

The taxpayer, an Indian company, had the right to use certain trademarks under the name and style of Brand 'A' and Brand 'B'. In 1981, only detergents were marketed under Brand 'A'. Subsequently, detergent cakes and soaps were introduced in 1986 and 1989 respectively, and Brand 'B' products (soaps and detergents) were introduced in 1997 and 1998. During the FY 2000-01, the taxpayer sold its rights in the above trademarks for

INR4.5 billion. The taxpayer, relying on the decision of the SC in the case of CIT *v.* B. C. Srinivasa Setty [1981] 128 ITR 294 (SC), took the view that no capital gains arose on the above transfer as the trademarks were self-generated assets, and did not have a cost of acquisition. This view was not accepted by Revenue. However after the first round of the Tribunal appeal, the taxpayer bifurcated the consideration received on sale of rights in trademarks into two parts, *viz.* consideration for value of 'trademarks used in 1981' and 'other trademarks' in the ratio of 31.55 percent and 68.45 percent respectively, based on a valuation report.

Held

The Tribunal observed that under section 38 of the Trademarks Act 1999, it was always open to the owner of a registered trademark to assign a trademark wholly or in part. The restriction under section 44 of the Trademarks Act, 1999 was that associate trademarks were assignable and transferable only as a whole, and not separately, but subject to those provisions, they would, for all other purposes, be deemed be registered as separate trademarks. Considering the above, and the facts of the case, the Tribunal held that consideration received on sale of rights in trademarks should be apportioned into trademarks existing on 01 April, 1981 and trademarks developed subsequently, and capital gains had to be computed accordingly. Capital gains on brand 'A' (developed before 1 April, 1981) would be calculated by considering the proportionate sale consideration, being 31.55 percent as per valuation report, and the FMV as on 01 April, 1981 would be considered as its cost of acquisition. For computing capital gains on Brand 'B' (developed after 01 April, 1981), the Tribunal relied on the ruling of the co-ordinate bench in Smt. Shantaben K. Patel (ITA No. 421/ Ahd/ 2005), and concluded that its cost of acquisition could not be determined, and therefore, the proceeds were not subject to capital gains tax.

Editor's note

This ruling confirms the view that composite consideration for assignment of trademarks associated with a common brand can be divided into/ allocated to individual trademarks, and consequent capital gains should be computed accordingly. This may result in computation of period of holding of the respective trademarks and division of capital gains resulting from a composite transaction into long-term gain and short-term gain. A point worth noting is that in this case, the contention that, in the absence of a cost of acquisition, FMV as on 01 April, 1981 could not be substituted, was not canvassed.

Taxability of deferred consideration

CIT *v.* Mrs. Hemal Raju Shete [2016] 68 taxmann.com 319 (Bombay)

Accrual of any capital gains on consideration that is receivable in the future, and contingent upon a prospective event, cannot be chargeable to tax in the initial year of transfer of capital asset.

Facts

The taxpayer and other shareholders had transferred 100 percent shares in a company for an initial consideration of INR27 million received immediately on closing. Further, deferred consideration of upto a maximum of INR173 million, to be computed on the basis of the earnings of the company for each of subsequent four years, was receivable by the taxpayer and other shareholders. Accordingly, the taxpayer offered capital gains computed on the basis of her share of initial consideration received, while the TO sought to tax the gain based on her share in entire consideration, i.e., INR200 million. On appeal, the CIT(A) and the Tribunal ruled in the taxpayer's favour and deleted the TO's addition. The Revenue thereafter filed an appeal to the HC.

Held

The HC observed that the formula prescribed in the agreement made it clear that the deferred consideration was dependent on profits to be made by the company in future. Thus, in the absence of profits of the company,

no consideration would be receivable by the taxpayer; thereby, the deferred consideration was not an assured consideration and could not be said to have accrued. The HC observed that if the taxpayer acquired a right to receive such income, then the income could be said to be accrued to him, even if the same was received at a later date on being ascertained. Since the amount had neither been received nor had it been accrued to the taxpayer, on account of the consideration being contingent upon future profits of the company, it could not be said that any right to receive such income had accrued to the taxpayer in the initial year. The Revenue's contention that the impugned order was seeking to tax the amount on receipt basis, therefore, was not correct.

Editor's note

This is a welcome ruling of the Bombay HC, since the view that only the consideration that has accrued/ been received in the year of transfer is chargeable to capital gains tax, has been affirmed. Therefore, in various transactions involving deferred consideration, (viz., earn out deals) where the consideration is contingent upon occurrence of certain future events/ formula and is not ascertainable in the initial year of transfer, the entire estimated consideration would not be taxable in the year of transfer of asset. However, this ruling does not answer the question of whether the consideration is taxable on receipt basis, i.e., as and when the deferred consideration is received in future.

Loss on sale of shares within lock-in period to group company disallowed and held as sham transaction

AAA Portfolio *v.* DCIT [ITA No. 2483/ Del/ 2010 (Delhi-Tribunal)]

Taxpayer's transaction of purchase and sale of shares with a group concern, during the lock-in period as per SEBI regulations, was a sham transaction and thus disallowed short-term capital loss (STCL) arising on sale of shares.

Facts

The taxpayer and Company A were part of a group with the same set of directors. Company A held share warrants of Company B (a listed company) obtained under preferential allotment (issued in March 2006) with an option to convert each share warrant into one equity share at a price of INR 84 per share, 10 percent of which was payable upfront and the balance 90 percent at the time of conversion into equity shares. One of the conditions for the preferential allotment was that the failure to exercise conversion option before 29 September, 2007 would result in the forfeiture of the initial 10 percent amount paid by the allottees. At the time of conversion into equity shares, Company A did not have adequate funds for payment of conversion price, and approached the taxpayer to finance the balance 90 percent of the conversion price, and in turn acquire the equity shares of Company B from Company A at a price of INR 84 per share. The market value at the relevant time of the aforesaid shares was between INR 106 and INR 133 per share. The shares were not transferred in the name of the taxpayer due to the imposition of lock-in period till March 2009 as prescribed under relevant SEBI guidelines. The taxpayer claimed that it faced huge tax demands in September 2008 for which it had to liquidate its investments. Company B's shares were neither tradable in the stock exchange nor transferrable before the three-year lock-in period. The taxpayer thereafter sold shares of Company B in an off-market transaction back to Company A at INR 54 per share and claimed STCL on such sale transaction. The market price of Company B's shares at Bombay Stock Exchange at the time of such sale was INR 59 per share.

Held

The transaction of sale and purchase was not permissible and was legally prohibited during lock-in period. Thus, purchase and sale of shares without legally permissible physical transfer of shares was a sham transaction, and the STCL generated on such transaction could not be allowed. The Tribunal agreed with the Gujarat HC ruling in the case of ACIT *v.* Biraj Investment Private Limited [2012] 82 CCH 180 (Gujarat) and Madras HC ruling in the case of CIT *v.* M.Ramaswamy [1985] 151 ITR 122 (Madras), about the transferee gaining rights of ownership even in case his name was not entered into the register of members. However, it distinguished the taxpayer's case on the ground that the current transaction was entered into during the lock-in period,

and was effected between group companies. The Tribunal took note of the fact that the taxpayer, Company A and Company B were part of the same group, and thus agreed with the findings of lower authorities that the sale of shares effected between two group companies having the same directors during the lock-in period was without any good cause. The Tribunal pointed out that no document had been submitted by the taxpayer to show the urgency and necessity to pay tax demands. The Tribunal upheld the impugned order of TO and confirmed the disallowance and addition made by the TO.

Editor's note

The Tribunal, based on specific facts, held that the purchase and sale of shares during the lock-in period was not permissible and legally prohibited, and thus was a sham transaction. The taxpayer's explanation for such sale was factually incorrect, and accordingly not acceptable.

For SPV controlled and managed in Mauritius, capital gains on sale of shares in Indian company held to be taxable in Mauritius only

[A.A.R. No. 991 of 2010]

Tax resident of Mauritius, holding a Mauritian TRC with entire control and management of its affairs situated in Mauritius, was entitled to benefit under Article 13(4) of the India-Mauritius tax treaty. The AAR rejected the Revenue's contention that the applicant was incorporated without any "economic substance" with the sole purpose to hold shares to facilitate tax-neutral share transfer, and that control and management of its affairs was situated in India.

Facts

The applicant was incorporated in Mauritius on 9 May, 2005 and held a valid TRC issued by the Mauritian revenue authorities. M Limited, a company incorporated in Mauritius, held 57 percent and B Limited, UK held 43 percent of the applicant's shares. On 28 December, 2004, T Limited (then an unlisted company) and A Inc. had entered into a software and professional services agreement (agreement 1) wherein it was understood between the parties that A Inc. could become a shareholder of TML if it generated/ achieved a certain amount of business for T Limited. On 10 May 2005, the applicant along with A Inc., B Limited, M Limited and T Limited entered into an option agreement, under which A Inc., on achieving certain milestones, was entitled to purchase up to 9,931,638 shares of T Limited from the applicant. After this, on 09 July 2005, the applicant acquired 9,931,638 shares in T Limited at a price of INR 67 per share. T Limited was subsequently listed on the Bombay Stock Exchange and the National Stock Exchange. T Limited filed a draft prospectus (for listing on stock exchange) in 2006, which mentioned that the agreement 1 was not acted upon. On 22 March, 2010, A Inc. exercised the option to purchase the shares of T Limited. Consequently, the applicant sold 9,870,912 T Limited shares and earned a long-term capital gain of INR910.1 million. The applicant had approached the AAR for a ruling on the taxability of the above capital gains in India. Initially, the AAR (2012) 24 taxmann.com 296 (AAR) refused to provide a ruling on the ground that the arrangement of the share issue and transfer was designed to circumvent the SEBI Guidelines, and thus impaired public interest. The AAR stated that it could not ignore this illegality, even if no tax avoidance motive existed. However, on a writ petition to the Bombay HC, considering the clarification from the SEBI that there was no breach of guidelines, the HC restored the matter to the AAR for its ruling.

Held

The Revenue's contentions that the applicant was holding shares only for ultimately transferring the same to A Inc., and that the applicant was not set up for a commercial purpose, were misplaced. The option provided to A Inc. for purchasing T Limited shares on achieving pre-determined milestones was only to motivate A Inc. to generate business for T Limited. The AAR further commented that there was nothing unusual in such an agreement. The main issue to be addressed was whether the control and management of the affairs of the applicant were situated wholly in India. The AAR observed the following, and concluded that the control and

management of affairs of the applicant were not wholly situated in India:

(i) Based on facts and judicial precedents presented by the applicant, it could not be said that the control and management of the affairs of the applicant were wholly situated in India.

(ii) The Revenue's only argument was that the real transaction was between T Limited and A Inc., and therefore, the control and management of the applicant should have been treated as in India. There was no force in this argument. The Department did not produce any substantial evidence to show that any important affairs of the company relevant for the purpose of the Act were being controlled from India.

In view of the above, it ruled that Article 13(4) of the tax treaty would apply, and that the applicant would not be chargeable to tax in India. Since the income in question was not taxable in India, the AAR did not rule in relation to the applicable tax rate in India.

Editor's note

In this ruling, the AAR appears to have given sufficient weightage to the business purpose of entering into the option agreement. The ruling has re-iterated the basic criteria for determination of place of control and management of affairs of a company.

Supreme Court upheld tax on capital gains on transfer of interest in partnership asset in the hands of partner

Vatsala Shenoy *v.* JCIT [Civil Appeal No. 1234 of 2012]

The taxpayer is liable to pay tax on capital gains on consideration received towards transfer of their interest in the net assets of the partnership business. The SC also held that as consideration was fixed on the basis of valuation of assets, the sale was not a slump sale but an itemised sale.

Facts

The taxpayer was a partner in a partnership firm (firm). The firm was last reconstituted between 13 persons for a fixed duration of five years that could be extended by six months *vide* partnership deed dated 30 June, 1982 (the deed). The firm was dissolved on 6 December, 1987 by afflux of time; however, the affairs of the firm could not be wound up due to difference of opinion among the erstwhile partners of the firm. Two partners filed a winding up petition with the Karnataka HC under Part X of the Companies Act 1956, allowing the winding up of unregistered companies, including partnership firms. Clause 16 of the deed provided that in case of dissolution of the firm, the firm's business, as a going concern, would vest in the partner or group of partners offering the highest bid at a sale held amongst the partners. In view of the above, the HC passed an interim order on 05 November, 1988 and permitted a group of seven partners to continue the business till the completion of winding up proceedings. The final order was passed on 14 June, 1991 for winding up the firm's affairs by selling its assets as going concern to such partner/ (s) who made an offer of the highest price. A reserve price of INR0.3 billion was fixed. The successful bidder was also required to pay interest @ 15% p.a. from 06 December, 1987 until the date of deposit of consideration. The valuers had valued the firm's land, building and machinery at INR39 million and goodwill at INR261 million. This was the basis for fixing the reserve price of INR0.3 billion. On 17 September, 1994, the HC passed an order accepting a bid of INR0.92 billion made by three partners as association of person (AOP-3). The AOP-3 deposited the bid amount and were handed over the business on 07 January, 1995. Sometime in 1993, one of the partners assigned his interest in the firm to seven other partners. After this assignment, the firm consisted of 12 partners. Considering that three partners were acquiring the business, the remaining nine partners were referred to as outgoing partners. The taxpayer was one of the outgoing partners. The AOP-3 deposited the bid amount in respect of outgoing partners after adjusting the amount standing to the accounts of three partners who were members of AOP-3. The AOP-3 succeeded the firm's business and constituted a new firm in the same name. The return of income of the taxpayer for the assessment year 1995-96 did not include any amount as capital gain in relation to the sale of the firm's business. The TO computed capital gains on sale of the firm's business, and held that gain proportionate to

the taxpayer's share in the firm was taxable in the taxpayer's hands as capital gain on transfer of interest in the firm's assets. The CIT(A), Bangalore, the Tribunal and the Karnataka HC sustained the TO's order.

Held

Issue 1

The assets of the firm that were sold, were a capital asset within the meaning of section 2(14) of the Act. Once held to be a capital asset, gain therefrom had to be treated as capital gain within the meaning of section 45 of the Act. Separate valuations for land, building, machinery and goodwill were obtained to enable the HC to fix the reserve price. Such valuation had to be treated as that of the firm. Even if the assets were sold as a going concern, the reserve price of INR0.3 billion was derived after considering the value of each asset of the firm. Section 2(42C) of the Act, defined a "slump sale" as the transfer of one or more undertakings as a result of the sale for a lump-sum consideration, without values being assigned to the individual assets and liabilities in such sales. The sale in question could be treated as slump sale only if no value had been assigned to the individual assets and liabilities in such sale. In this case, the values assigned to individual assets, and even liabilities, had been taken care of when the sale proceeds were apportioned amongst the outgoing partners. Therefore, this was not a case of "slump sale."

Issue 2

On the firm's dissolution, the partners became entitled to a proportionate share in the firm's assets, and together could be compared to tenants-in-common. The TO's order holding that the erstwhile partners were liable to pay tax on capital gains on the amount received towards the value of their share in the firm's net assets was justified. Accordingly, the HC's decision that the amount received by the taxpayer towards the value of net assets of the firm would attract capital gain was upheld.

Editor's note

The SC has reiterated that a sale of assets can be treated as a slump sale only if no value had been assigned to the individual assets and liabilities. If values are assigned to the individual assets and liabilities, the same cannot be characterised as a slump sale.

The SC also upheld the principle that extinguishment/ transfer of interest in partnership assets for a consideration results in the transfer of capital asset liable to tax. However, the court has not dealt with the issue of cost of acquisition of such right. The taxpayer had raised this issue before the Tribunal, and claimed that in absence of such cost, it should not be liable to tax. The Tribunal had held that a partner acquires right in the firm's assets the moment he/ she becomes a partner therein. Further, the Tribunal had held that difficulty in ascertaining cost should be distinguished from the impossibility of envisaging the cost of an asset, and had held that in this case, the argument that there was no cost of acquisition fails. As the SC has not yet dealt with this issue, the same may still be subject matter of further debate.

Capital gains not chargeable on transfer of undertaking without consideration by a wholly-owned subsidiary to its holding company under a scheme of arrangement

ITA No. 341/ Mum/ 2014 (Mumbai-Tribunal)

The hive-off of the telecom business by A Limited to its holding company, I Limited, without any consideration pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956 (Scheme), and duly approved by the jurisdictional HCs, was not subject to capital gains tax liability under section 45 of the Act.

Facts

A Limited had a unified access services license since November 2006 for providing telecom services in Bihar (including Jharkhand). A Limited became a wholly owned subsidiary of I Limited with effect from 28 February, 2007. During FY 2009-10, A Limited and I Limited had entered into a scheme whereby the following steps were sought to be undertaken:

(i) Transfer of the telecom business of A Limited to I Limited without any consideration; and

(ii) in A Limited's books, the revaluation of an investment in C Limited, an asset separate from the telecom business of A Limited and retained by A Limited. As a result of such revaluation, a business restructuring reserve was created in A Limited's books. The Scheme was duly sanctioned by the jurisdictional HCs in FY 2009-10 itself without any modifications.

Held

The Tribunal took cognisance of the fact that the transfer of the telecom business of A Limited was without any consideration and the scheme specifically provided for the same. Further, the jurisdictional HCs had duly approved the scheme without any modifications. Therefore, no consideration had accrued to A Limited upon the transfer of its telecom business. Further, it observed that in absence of a specific enabling provision in the Act, the TO did not have any power to substitute the consideration envisaged in the scheme, or to impute a notional gain based upon a hypothetical consideration. Therefore, it held that it was unjust and unwarranted to impute or assume a notional consideration for computation of capital gains tax. The Tribunal while ruling in favour of A Limited also accepted other contentions raised by A Limited. Accordingly, the Tribunal deleted the capital gains tax liability sought to be levied by the Revenue authorities.

Editor's note

This judgment deals with many legal facets, such as permissibility of corporate gift, impossibility of computation of capital gains in absence of a particular element, restriction on the TO's powers to impute hypothetical consideration, inapplicability of section 50C of the Act to a case of transfer of undertaking as a whole versus itemised transfer of land or building and inapplicability of section 50D of the Act if there is no consideration accruing to the taxpayer. Therefore, this judgment provides greater clarity on various issues involved in any corporate restructuring.

Amalgamation

"Appointed date linked to Effective date" in merger scheme–which was contingent on receipt of RBI license – Scheme allowed by HC

Equitas Housing Finance Limited & Ors. *v.* Regional Director [C.P. No. 119 to 121 of 2016 (Madras)]

In Scheme of merger (Scheme) sanctioned for A Limited and B Limited into C Limited, the appointed date was linked to the effective date.

Facts

A Limited (transferor company 1), B Limited (transferor company 2)(collectively transferor companies), and C Limited (transferee company) had filed Petitions with the HC for merger of both transferor companies with the transferee company. The transferor companies and the transferee company were collectively referred to as petitioner companies. The holding company of the petitioner companies, i.e. D Limited (Hold Co.) had applied to the RBI for grant of license to establish a Small Finance Bank (SFB) in the private sector. RBI granted in-principle approval subject to certain conditions, to be complied with within 180 days, which *inter alia*, included the merger of transferor companies with the transferee company to be effected prior to the commencement of the SFB business. Clause 1.2 of the Scheme defined the appointed date with reference to the effective date. Clause 1.7 of the Scheme defined effective date to mean a working day immediately preceding the date of commencement of SFB business. The Scheme provided that the share exchange ratio would be arrived at based on the book value of the shares of the petitioner companies, as on the effective date. The Scheme also envisaged dissolution of transferor companies on the 30th day from the effective date, or in the alternative, transferor companies would file separate applications with the HC for dissolution without winding up. The RD had raised objection that the Scheme did not specify any specific appointed date and that the share exchange ratio was also linked to such date.

Held

The HC considered that the Scheme could not provide a clear appointed date as the in-principle approval did not guarantee issue of banking license. A perusal of section 394 of the Companies Act, 1956 showed that the HC, either while sanctioning the Scheme, or by a subsequent order, was entitled to make provisions for all or any of the matters, including dissolution without winding up of the transferor companies, which may be necessary to ensure that amalgamation was fully and effectively carried out. The HC observed that RD had not shown any impediment in law in accepting the tenability of provisions incorporated in the Scheme relating to "appointed date," "effective date" and the share exchange ratio. The HC held that section 394(1) provided it leeway to sanction the Scheme where the actual date of amalgamation/ merger was delayed until the necessary

prerequisites were fulfilled, and sanctioned the Scheme. As regards the dissolution of transferor companies, the HC accepted the alternative proposal and ordered the transferor companies to file separate applications for their dissolution within 30 days of the effective date.

Editor's note

The HC has the leeway to sanction a scheme of amalgamation where the actual date of amalgamation/ merger may be delayed until necessary pre-requisites, if any, are fulfilled. This decision provides clarity on the need for a specific appointed date in a scheme.

Purchase method of accounting upheld in case of merger of wholly owned subsidiaries into parent company

Sadavani Investments and Trading Company Private Limited *v.* Regional Director [Company Scheme Petition No. 406, 407 and 408 of 2015 dated 18 March, 2016 (Bombay)]

Purchase method of accounting could be followed on merger of wholly owned subsidiary into the parent company, as it was not restricted by the relevant accounting standard. Intention of transferee to make adjustments to book value of assets and liabilities of transferor companies by recording them at fair value was sufficient to justify rejection of adoption of pooling of interest method.

Facts

A scheme of merger was filed with the HC for the merger of two wholly owned subsidiaries into the parent company by following the purchase method of accounting. The assets of both transferor companies comprised only of investment in shares of a listed company, and no other asset. The current Accounting Standard on Accounting for Mergers provides for the following two methods of accounting:

- The pooling of interests method (subject to fulfilment of certain conditions) wherein assets and liabilities were recorded at their existing carrying values by the transferee company.
- The purchase method wherein assets and liabilities could be recorded at fair value on the date of merger by the transferee company.

Held

Under the current accounting standards, a company could adopt either of the two accounting methods. The pooling of interests method could be followed only on satisfaction of prescribed conditions, and if any of the conditions was not satisfied, this method cannot be followed. One of the conditions is that the transferee company should have no intent to make adjustments to the book values of assets and liabilities of the transferor companies. However, in the instant case, the transferee company clearly had intentions to make adjustments to the book value of assets and liabilities of the transferor companies by recording them at fair value. Accordingly, the pooling of interests method could not be followed in the current situation. In fact, had the transferee company proposed to follow the pooling of interests method, it would have been contrary to accounting standards and completely incorrect.

Editor's note

The judgment upholds the view that the purchase method of accounting can be followed in case of the merger of a wholly owned subsidiary into the parent company.

Demerger

In case of demerger, MAT credit, advance tax and withholding tax credit of demerged company allowed to resulting company on a **pro rata** ***basis***

I.T.A Nos. 2241 & 2516/ Ahd/ 2011 (Ahmedabad-Tribunal)

In case of demerger, the resulting company was held entitled to utilise MAT credit, advance tax and withholding tax credit for the period after the appointed date and pertaining to the demerged undertaking on pro rata *basis.*

Facts

The taxpayer was the Resulting Company in a demerger scheme (Scheme) approved by the Gujarat HC. As per the Scheme, all assets and liabilities of the demerged undertaking were to be transferred to the Resulting Company. Post approval of the Scheme, both the companies (i.e. the Demerged Company and the Resulting Company) revised their return of income and bifurcated the income and taxes paid (including MAT credit) between the Demerged Company and the Resulting

Company respectively on *pro rata* basis. However, the TO disallowed credit of taxes paid (including MAT credit) in the hands of the Resulting Company, contending that the Scheme did not speak of bifurcations of tax credits. The CIT(A) upheld the TO's order on the aforementioned grounds.

Held

In the taxpayers' case, demerger arrangement covered transfer of all assets and properties of the demerged undertaking, followed by all of its debts, liabilities, duties and obligations. Further, these general expressions were further clarified in the Scheme to include deferred tax benefits as well, to name one. The Revenue did not allege any claim of double relief of the impugned credits. The CIT(A)'s findings that no bifurcation of income and taxes was made in the Scheme contradicted the case record as well as the statutory meaning of a demerger. Relying on the SC judgment in the case of Marshall Sons & Company (India) Limited *v.* ITO [1997] 223 ITR 809 (SC) and the Gujarat HC judgment in the case of Torrent Private Limited *v.* CIT [2013] 217 Taxmann 149 (Gujarat), it was held that in the demerger, the demerged undertaking no more existed with effect from the appointed date, and that the taxpayer (i.e. the Resulting Company) was entitled to *pro rata* benefits of advance tax paid by and MAT credit and withholding tax credit available to the Demerged Company in relation to the demerged undertaking as per law.

Editor's note

The Tribunal allowed pro rata *adjustments of tax credits (such as MAT credits) pertaining to the demerged undertaking to the Resulting Company. It may be noted that there is no specific provision for transfer of MAT credit on demerger under the Act. Although there are rulings on the transfer of MAT credit on merger, this is the first ruling in the case of a demerger, and may be pertinent for companies contemplating restructuring such as merger and demerger.*

Minimum Alternate Tax

Loss on transfer of division debited to income statement not to be added back for computing book profit for MAT, if accounts prepared in accordance with Companies Act requirements

CIT *v.* Binani Cement Limited [2016] 67 taxmann.com 281 (Calcutta)

Loss on transfer of a division of a company debited to the income statement (a.k.a. profit and loss account) could not be added back when computing book profits for the purpose of MAT.

Facts

The taxpayer, an Indian company, had entered into a scheme of arrangement wherein its investment division was transferred to a transferee company. The consideration for the transfer was discharged by the transferee company through issue of shares to the taxpayer's shareholders. The taxpayer incurred a loss on the transfer of the division, as the consideration was received by the taxpayer's shareholders. The taxpayer adjusted part of this loss against its capital account, and the balance loss was debited to the income statement. The loss debited to the income statement was not added back for computing the book profit for MAT purposes. The statutory auditors had not qualified its report for this accounting treatment of debiting the loss to the income statement. Additionally, the shareholders had approved the financial statements. The TO did not make adjustments; however, the CIT set aside the assessment order and passed a revision order, directing the TO to consider adding back the amount debited to the income statement while computing book profit for MAT under section 115JB of the Act. The Tribunal held that for computation of book profit for MAT, tax authorities could not make adjustments to book profit arrived on the basis of the profit & loss account that were prepared in accordance with the requirements of the Companies Act, and were duly approved by the auditors and shareholders of the company.

Held

Accounting Standard 13 requires that the loss on disposal of an investment had to be recognised in the income statement.

Accordingly, the taxpayer had correctly debited the income statement with the loss on transfer of the investment division. The HC emphasised that in the SC's judgment in the case of Apollo Tyres Limited *v.* CIT [2002] 255 ITR 273 (SC), it had been held that the TO did not have the jurisdiction to investigate the net profit shown in the income statement, except to the extent provided in the law for MAT purposes, or in cases where the accounts were not prepared in accordance with the requirements of the Companies Act.

Editor's note

The HC has held that loss on transfer of investment division debited to Income Statement cannot be added back for computation of Book Profits for MAT purposes if accounts were prepared in accordance with the requirements of the Companies Act. This HC judgment is pertinent for companies undertaking restructuring.

Business loss

Share allotted in IPOs are not "purchased" within the meaning of Explanation to section 73; gain/ loss on sale of such shares cannot be deemed to be speculative business thereunder

AMP Spinning & Weaving Mills Private Limited *v.* ITO [Tax Appeal No. 957 of 2006 with Tax Appeal No. 1644 of 2008]

Allotment of shares pursuant to an application in public issue did not amount to "purchase" under Explanation to section 73 of the Act. The HC accepted the taxpayer's contention that there was a vital difference between "creation" and "transfer" of shares, and hence, allotment of shares in IPO did not amount to purchase. Concomitantly, the HC held that the sale of such shares did not amount to speculative business under the said Explanation.

Facts

The taxpayer was a dealer in chemicals as well as in shares. The taxpayer applied for shares in IPOs of certain companies and was allotted shares that it eventually sold, and in the process, suffered a loss. He treated the loss on the sale of such shares as business loss. The TO treated this loss as speculation loss, applying the Explanation to section 73 of the Act. The CIT(A) confirmed the treatment of loss as a speculative loss. On appeal to the Tribunal, the matter was referred to a SB, which held that the loss on account of trading in shares was a speculative loss.

Held

The HC relied on the SC's judgment in the case of Khoday Distilleries Limited *v.* CIT [2008] 307 ITR 312(SC), wherein it had been held that there was a vital difference between the "creation" and "transfer" of shares. The words "allotment of share" had been used to indicate the creation of shares by appropriation out of the unappropriated share capital, to a particular person. Whichever rule of interpretation was followed, literal, object-wise or purposive, the taxpayer's transactions could not imaginably be deemed to be a speculative business. As the allotment of shares could not be termed as purchase, the taxpayer could not be said to be carrying on a speculative business to the extent to which the business consisted of the purchase and sale of such shares. Thus, it would not be covered under Explanation to section 73 of the Act. The Tribunal was wrong in holding that getting allotment of shares in a public issue was a "purchase" as used under Explanation to section 73, and in holding that the sale of such shares became a speculation business thereunder.

Editor's note

The HC has categorically distinguished allotment of shares by a company and purchase of shares from existing shareholders. This decision provides some guidance that an issue of shares may not result in direct/ indirect transfer under section 2(47) of the Act for the purpose of taxability under the head, "capital gains".

FMV of shares

FMV of shares of a private company, for recipient taxation, to be computed as per the rule prescribed even if shares are transferred at a different value

ITA No. 871/ Hyd/ 2015 (Hyderabad-Tribunal)

TO held obliged to compute the FMV as per Rule 11UA of the Rules irrespective of the market value of the shares transferred while applying section 56(2)(viia) of the Act in the hands of the purchaser.

Facts

During the relevant financial year, the taxpayer purchased shares of its group company (both closely held companies). The taxpayer purchased some shares from unrelated parties at INR 75 per share and from some other shareholders at INR 01 per share. The FMV of the shares as per Rule 11UA was INR (minus) 64 (*sic*) per share. The TO disregarded the FMV computed as per Rule 11UA and treated the amount of INR 75 per share as "FMV" for determining the amount of deemed gift as per provisions of section 56(2)(viia) of the Act, and computed deemed income accordingly. The CIT(A) upheld the TO's order and ruled in favour of the Revenue.

Held

Where a method had been prescribed by the legislature, that method alone should be followed for computation of FMV. Accordingly, adoption of "market value" of shares in place of "FMV" as per Rule 11UA of the Rules for the purpose of section 56(2)(viia) of the Act was incorrect. The Tribunal relied on legal principles laid down in earlier judgments (Bharat Hari Singhania & Others *v.* Commissioner of Wealth Tax [1994] 207 ITR 1 (SC); Mrs. Prem Shamsher Singh *v.* Commissioner of Wealth Tax [1994] 210 ITR 233 (Delhi); Chandra Kishore Jha *v.* Mahavir Prasad & Ors. [1999] 8 SCC 266 (SC)). It further held that where the legislature in its wisdom had provided a formula for computation of FMV, the same could not be ignored by the lower authorities. Accordingly, it concluded that section 56(2)(viia) of the Act could be applied only in accordance with the prescribed rules, and therefore, the TO ought to have necessarily computed the FMV in accordance with Rule 11UA of the Rules.

Editor's note

The Tribunal has reaffirmed a very important judicial principle that where computation mechanism is prescribed, the same has to be mandatorily followed by the TO. Accordingly, in the context of application of section 56(2)(viia) of the Act, the TO has to necessarily compute the FMV as per Rule 11UA, irrespective of the market value of the shares transferred.

Conversion of firm to company

Taxability in case of conversion of firm into company under Part IX of the Companies Act, 1956

DCIT *v.* R.L. Kalathia & Co [2016] 66 taxmann.com 249 (Gujarat)

Conversion of a firm into a company was not a transfer (even before section 47(xiii) was introduced) and would not be subject to capital gains tax.

Facts

The taxpayer, a partnership firm, was engaged in the business of real estate development. In 1980, the taxpayer had taken land on lease for a period of 99 years on a monthly rent. The land and building (a shopping centre) was shown as a non-business asset, and income thereon was offered as income from house property. The property cost was not recorded in the books of the taxpayer until FY 1995-96. During FY 1995-96, the taxpayer revalued its land and building, including the shopping centre, and the revaluation difference was credited to the partners' capital accounts in their profit-sharing ratio. Thereafter, on 16 February, 1996, the taxpayer converted itself into a limited company under Part IX of the Companies Act, 1956, and shares of the converted company were allotted to the partners of the erstwhile firm. The TO opined that the shopping centre, which he contended had been introduced into the firm by way of revaluation of assets, was nothing but the income earned by the taxpayer in the year of revaluation, and should be chargeable to tax under section 28(iv) of the Act. Alternatively, the TO observed that the conversion of firm

into company should have been chargeable to capital gains tax under section 45 of the Act. However, the TO finally assessed the income on conversion of the firm under the head, capital gain. The CIT(A), while dismissing the validity of the claim that it was chargeable under section 28(iv) of the Act, upheld the TO's order charging capital gains tax on conversion of firm into company, stating that the firm and the company were two separate entities. On further appeal, the Tribunal held that the conversion of firm into company could not be brought within the ambit of section 45(1) of the Act as there was no consideration received by the taxpayer. It also held that section 45(4) was not applicable, as the element of distribution of capital assets *in specie* by the firm was missing in case of conversion of firm into company.

Held

In the case of Artex Manufacturing Co. *v.* CIT [1981] 131 ITR 559 (Gujarat), while all assets and liabilities of the firm came to be transferred to the company as a going concern, it was not a case of conversion of firm into company under Part IX of the Companies Act 1956. No facts had been brought on record to establish that the properties had been brought into the books of the taxpayer as stock-in-trade. On the contrary, the taxpayer had always treated the said shopping centre as a capital asset. The decision of the Bombay HC in the case of CIT *v.* Taxspin Engg. & Mfg. Works [2003] 263 ITR 345 (Bombay) squarely applied to the present case, and hence, conversion of firm into company under Part IX was not taxable under section 45(1) of the Act. Section 45(4) of the Act would also not apply to the taxpayer, as the primary requirement for invoking section 45(4) of the Act was that there had to be a distribution of capital assets of the firm, which was entirely missing in the present case.

Editor's note

The Gujarat HC decision has reaffirmed that the conversion of firm into company does not amount to transfer under section 2(47) and is not liable to capital gains tax. Though the decision pertains to an assessment year prior to insertion of clause (xiii) to section 47 of the Act, since it considers that conversion is not a transfer, it impliedly confirms non applicability of section 47(xiii) of the Act to a case of conversion under Part IX of the Companies Act, 1956.

Diversion of income

'Income-diversion' principle inapplicable where shareholders directly received consideration on sale of company's undertaking under a scheme of arrangement

CIT *v.* M/s Salora International Limited [ITA No. 12/ 2003 (Delhi)]

Part consideration on the sale of business of the taxpayer paid directly to taxpayer's shareholders was taxable in the hands of the taxpayer as sale consideration (in addition to the part consideration already received by it) for computing capital gains since the same was not "diversion of income at the very source."

Facts

The taxpayer had sold one of its undertakings manufacturing colour televisions and audio systems for a consideration of INR501.2 million, to the transferee company, through a Scheme of Arrangement under sections 391-394 of the Companies Act, 1956 (Scheme). Out of the total consideration, INR324.8 million was payable to the taxpayer (discharged partly in cash and partly in the form of shares of the transferee company) and INR176.4 million was payable to the shareholders of the taxpayer (discharged in the form of shares of the transferee company). In its return of income for the relevant year, the taxpayer computed its capital gains tax liability on the basis of the consideration to which was payable to it. Accordingly, the taxpayer declared a capital loss by deducting the book value of its business sold as its cost of acquisition, from the consideration it received. The taxpayer contended that the part of consideration discharged to its shareholders directly was neither received by, nor accrued to, the taxpayer but was in effect a diversion of income at source. The TO and the CIT(A) rejected this claim and held that the consideration directly discharged to its shareholders had accrued to the taxpayer. It further adopted the WDV of the fixed assets as per the Act as the cost of acquisition, instead of the book value as adopted by the taxpayer in its return. In a further appeal by the

taxpayer, the Tribunal upheld the taxpayer's claim, both in respect of the consideration directly discharged to its shareholders (which it held did not accrue to the taxpayer), and in respect of the cost of acquisition adopted by the taxpayer. The revenue filed an appeal to the HC.

Held

While examining the limited question of accrual of part of the consideration discharged directly to the taxpayer's shareholders, the HC, ruling in favour of the Revenue, observed that the sanction of the scheme by the company court did not result in extinguishment of the taxpayer's liability on consideration paid directly to the shareholders. While placing reliance on the judgement of Bacha F. Guzdar *v.* CIT, Bombay [1955] 27 ITR 1 (SC), the HC observed that shareholders had a right to the company's profits, but not to its assets, since the company was a separate juristic person that held the assets in its own name. Shareholders could not therefore have a pass-through right on the assets, except on liquidation. Therefore, the consideration accrued only to the company selling its undertaking since it was an asset of the company, and not of its shareholders. Hence, though the mode of discharge of consideration was directly to the taxpayer's shareholders, it first accrued to the taxpayer and therefore had to be taxed in the taxpayer's hands. The HC further clarified that the expression "accruing" as used in section 48 of the Act was synonymous with entitlement, and therefore, if the taxpayer was entitled to the consideration, then it must be taken into account for computing capital gains under section 48 in the taxpayer's hands. The HC rejected the Tribunal's approach that since shareholders had acquired a right to receive shares under a statutorily binding scheme, there was diversion of income at source, and that mere sanction or approval under sections 391-394 of the Companies Act, 1956 would not alter the character of the scheme or the nature of transaction embodied therein for purposes of levy of income tax.

Editor's note

In this important judgement, the HC did not merely "look at" the form of the transaction but adopted a "look through" approach. It looked at the substance of the transaction and held that the consideration directly discharged to the taxpayer's shareholders had accrued to the taxpayer itself, and was not a case of diversion of income at source. The argument of impossibility of determination of acquisition cost of the undertaking was never advanced. Therefore, no reliance could have been placed on the SC's decision in the case of CIT v. *B.C. Srinivasa Setty [1981] 128 ITR 294 (SC). This decision could impact companies undertaking non-tax neutral transactions, and call for closer scrutiny of the facts in each case.*

Income from other sources

Receipt of bonus shares not subject to tax under section 56(2)(vii)

DCIT *v.* Dr. Rajan Pai [ITA No. 1290/ Bang/ 2015 (Bangalore-Tribunal)]

Receipt by an individual shareholder of bonus shares issued by the company would not be subject to tax in the recipient's hands, although the same was received without consideration.

Facts

The taxpayer, an individual, was a shareholder of a private limited company (the Company). The taxpayer had received 1,00,00,000 equity shares as bonus shares against his holding of 5,000 fully paid up equity shares in the Company. During assessment proceedings, the TO added the receipt of such bonus shares under the head 'Income from Other Sources' under section 56(2)(vii)(c) of the Act on the basis that the taxpayer had received the same without consideration. The TO made the addition on the basis of the fair market value computed under Rule 11UA of the Rules. Aggrieved, the taxpayer filed an appeal with the CIT(A) and argued that issuance of bonus shares amounted to capitalisation of profits, and did not result in any increase or decrease in the shareholder's wealth. Further, since the bonus shares were issued proportionately, no particular value could be attached to such bonus shares under section 56(2)(vii)(c). The CIT(A) ruled in favour of the taxpayer, relying upon the judgment of the Special Bench of the Mumbai Tribunal in the case of Sudhir Menon HUF *v.* ACIT [2014] 162 TTJ

425 (Mumbai-Tribunal). The Revenue filed an appeal with the Bangalore Tribunal against this order of the CIT(A).

Held

Delving into the legislative history of section 56(2)(vii) of the Act, the Tribunal observed that this provision was primarily introduced to address abuse arising out of abolition of the Gift Tax Act, 1958. It also observed that the erstwhile Gift Tax Act never included within its ambit issue of bonus shares issued by a company to its shareholders as gift. Further, it also observed that the bonus issue was detrimental to the shareholder in terms of value per share, which was counterbalanced by the additional number of bonus shares received. Therefore, the total value of equity shares post issuance of bonus shares remained the same. Since the issue of bonus shares was by capitalising profits of the company, it did not result in increase in net asset value of the company. In addition, any profit derived by the taxpayer on account of receipt of bonus shares was theoretically offset by the depression in the value of the equity shares already held by him. Therefore, it did not result in the taxpayer getting a property without consideration. Relying on the case of Sudhir Menon HUF, and also on the SC decision in the case of CIT *v.* Dalmia Investment Co. Limited [1964] 252 ITR 567 (SC), it observed that the bonus shares were ranked *pari passu* with the original shares, and they had to be valued at the average of both bonus and the original shares, with the total value of all shares remaining the same. Therefore, the Bangalore Tribunal held that in case of issuance of bonus shares, consideration had indeed flown out from the holder of the shares, which was reflected in the depression in the intrinsic value of the original shares held by him, and the bonus shares could thereby not be said to have been received without consideration.

Editor's note

This is a welcome ruling by the Bangalore Tribunal which reiterates the position in law that the deeming provisions of section 56(2)(vii) were introduced as anti-abusive provisions. Therefore, in cases where a taxpayer received some property without consideration, a closer look needed to be given to such a transaction, and whether such benefit was offset by any consequential decline in the intrinsic value of asset originally held.

Distribution of income by trust to beneficiaries not chargeable to tax under section 56(2)(vi)

Mrs. Sharon Nayak *v.* DCIT [I.T.A No.1594/Bang/ 2014 (Bangalore-Tribunal)]

Distribution of income by a trust to its beneficiaries would not be construed as amounts received without consideration by the beneficiaries, and hence, section 56(2)(vi) of the Act would not apply to such receipts. It also held that the TO had an option to assess the amount received by the taxpayer from various trusts as a beneficiary of such income, either in the hands of the trust or in the hands of the beneficiary. The Tribunal further held that if such option was exercised by the TO and income was taxed in the beneficiary's hands, income would be classified in the hands of the beneficiary in the same manner as it was classified in the hands of the trust.

Facts

The taxpayer, a beneficiary of an employee trust (the trust), earning salary and professional income had filed her return of income disclosing certain income received from twelve trusts floated by the taxpayers' employer. In the relevant AY, the trust had earned capital gains income and income chargeable under section 56(2)(i) of the Act, on which taxes were paid by the trusts. Thereafter, the trust distributed a part of the same income to the taxpayer. An intimation under section 143(1) of the Act was issued to the trust after commencing proceedings under section 143(2) of the Act on the taxpayer— thus, the TO exercised the option to assess the trust's income in the taxpayer's hands. The taxpayer claimed that since the trust had paid income tax on the amounts distributed, it should not be taxable in its hands. The TO contended that the amount received by the taxpayer from the trust should have been considered as emanating from her employer-employee relationship, and should have been chargeable under section 17(3) of the Act as profit in lieu of salary. The CIT (A) upheld the TO's order. He also stated that

if this amount was not taxed under section 17(3) of the Act, then it would have been definitely taxable under section 56(2)(vi) as it was a receipt without consideration.

Held

The Tribunal observed that though there was a connection of employment between the settlor and the taxpayer, there was no direct nexus between the payments affected by the trusts to the taxpayer. Therefore, the amount received by the taxpayer would not fall within the meaning of profit in lieu of salary. The Revenue had an option to assess and recover the tax from either the trustees or the beneficiaries of a discretionary trust, in respect of the income that had been distributed and received by the beneficiaries in the course of an accounting year. This principle had also been laid down by the SC in the case of CIT *v.* Smt. Kamalini Khatau [(1994) 209 ITR 101(SC)]. The Tribunal further held that for bringing a sum of money to tax under section 56(2)(vi) of the Act, it was necessary that the money should have been received by the taxpayer without consideration. In a trust, whether discretionary or otherwise, the trustees held the property and income for the benefit of the beneficiaries. The trust as such did not have a separate legal existence, but only represented its beneficiaries. Income of the trust was the income of the beneficiary. The trustees in a discretionary trust only had the power to decide when and how much money to distribute among the beneficiaries. Thus, what was received by the taxpayer as a beneficiary was nothing but his own income in his status as a beneficiary in the trust. What had flown from the trustee to the beneficiary was only the income collected by the trustee on behalf of the beneficiary. Once the character of income in the hands of the beneficiary took the same colour as that of the trust, and once it had been accepted that the trust as such did not have a *persona* distinct from its beneficiaries, it could not be said that the income was received without any consideration. Hence, the money received by the taxpayer from various trusts could not have been taxed under section 56(2)(vi) of the Act. Accordingly, the case was referred back to the CIT(A) for appropriate classification of income in the taxpayer's hands, and for apportioning it in the same ratio as such income bore to the income of the various trusts under different heads. As a corollary to the above decision, the Tribunal also held that if the taxpayer felt that the taxes paid by the trust were refundable since the taxes were assessable in the beneficiary's hands, it could move the appropriate authority for getting the relief. However, there was no enabling provision in the law which would empower the Tribunal to direct the TO to give credit of the taxes paid by the trust.

Editor's note

This decision reaffirms the position that distribution of income from a trust to its beneficiary, could not be said to be without consideration. Though this decision dealt with section 56(2)(vi), the ratio laid down in this case would squarely apply to section 56(2)(vii) of the Act as well.

This decision is in line with the view taken by the Mumbai Tribunal in the case of Ashok C. Pratap v. Additional IT [4615 (Mumbai-Tribunal) of 2011], wherein it was held that the amount received by a beneficiary from a trust (on its dissolution) could not be termed to be without consideration.

Share premium received held not liable to tax under Income-tax Act

ITA/ 993/ Mum/ 2015 (Mumbai-Tribunal)

Share premium received by the taxpayer could not be taxed as revenue receipt as "income from other sources" under section 56(1) of the Act.

Facts

The taxpayer, a company, was engaged in the business of providing various forms of business support and information technology enabled services and infrastructure support services to its group companies. During the year under consideration, the taxpayer had issued some shares at face value of INR 10 each and further shares at a premium. The premium received by the taxpayer was credited to Securities Premium under the head Reserves and Surplus in the Balance Sheet. The taxpayer relied on the CBDT Instruction No. 02/ 2015 dated 29 January, 2015, wherein it had accepted the order of the Bombay HC in the case of Vodafone India

Services Private Limited *v.* Union of India [2014] 50 taxmann.com 300 (Bombay) and had instructed its officers to treat the securities premium to be on account of a capital receipt and hence not giving rise to taxable income. The TO added the premium received as income from other sources. On appeal, the CIT (A) upheld the TO's order. The taxpayer filed an appeal before the Tribunal.

Held

The approach of the CIT(A) to tax premium on the basis of a contravention of the Companies Act, 1956 was fundamentally wrong. The taxability of an amount had to be decided within the four corners of the Act. Even the inclusive definition of income did not stipulate that non-compliance with a provision of any other Act would result in turning a capital receipt into a taxable revenue receipt. It observed that for determining taxes due, tax authorities should avoid far-fetched fancies and ideas. The Tribunal held that the tax authorities and the CIT(A), without understanding the basic philosophy of income, had referred to the Companies Act, so that the amount in question could be taxed. Even if the taxpayer had violated the provisions of the Companies Act, the taxpayer would be penalised under the Companies Act; however, that could never turn a capital receipt into a revenue receipt or *vice versa*. Considering the arguments raised by the taxpayer and the facts of the case, the Tribunal deleted the addition made on account of the share premium.

Editor's note

The Tribunal has reaffirmed the principle that the share premium could not be taxed as a trading receipt. The Tribunal has further affirmed that tax implications for a transaction had to be decided as per the provisions of the Act, and that violation of any other statute would not impact taxable income, unless specifically provided in the Act.

It is important to note that the decision relates to an assessment year before section 56(2)(viib) was inserted into the Act, which specifically provides for taxation of excessive premium on issue of shares to residents.

Capital gains—situs of capital asset

Income arising to non-resident from transfer of intangible property to another non-resident not taxable in India

WP[C] 6902/ 2008 (Delhi)

Absence of any contrary local legislation, the well-accepted principle of "mobilia sequuntur personam" *would have to be followed while determining the situs of intangible asset. Consequently, transfer from a non-resident to other non-resident of intangible asset, even though licensed to a person in India, could not be held to be transfer of capital asset situated in India. Consideration in respect of such transfer was, accordingly, not taxable in India under the provisions of the Act.*

Facts

The taxpayer had been in the business of brewing, processing, packaging, marketing, promoting and selling of beer products in Australia and abroad. It owned various brands, including its own brand in relation to beer products. The taxpayer had been holding certificates of registration of trademarks, and had been continuously using the brand since its registration. In India, the taxpayer had registered its trademark and logo in July 1993. It had entered into a Brand License (BL) agreement in October 1997 with A India, granting a brewing license to A India. In addition, it had also granted A India an exclusive right to use the trademarks in the territory of India in relation to 'ABC'. It had been paying taxes under the Act for royalty amounts received from A India. The taxpayer, in 2006, entered into a composite Sale and Purchase Agreement (ISPA) with C Limited, UK (C UK) for sale of shares and sale by the taxpayer of the trademark and Brand IP and to license the Brewing IP to C UK, confined to the territory of India. The consolidated consideration payable for the above was US$120 million. In terms of the ISPA, C UK made a deed of assignment in favour of its Indian subsidiary, D Limited, nominating it as the transferee in terms of the ISPA, following which the taxpayer granted to D Limited an exclusive, perpetual and irrevocable licence relating to the its Brewing IP. In addition, the BL agreement entered into between the taxpayer and A India had been terminated.

Subsequently, the intangible property had reverted to the taxpayer. The above events happened simultaneously. The taxpayer made an application to the AAR on taxability of consideration arising on transfer of its right, title and interest in and to the Trademark and Brand IP and grant of exclusive perpetual licence of the Brewing IP. The AAR held that there was no legal principle that the *situs* of intangible assets such as trademark and goodwill would always go with ownership, and intangible assets would have no *situs* other than the country of fiscal residence of the owner. The AAR also held that the trademarks registered in India, together with the other features of the brand, had undoubtedly generated appreciable goodwill in the Indian market, and such goodwill had been nurtured in India by the reason of coordinated efforts of the taxpayer and A India. Therefore, the AAR concluded that the intellectual property belonging to the taxpayer had its 'tangible presence' in India at the time of the transfer. Accordingly, the AAR ruled that the capital asset transferred by and through the ISPA, read with the Deed of Assignment were "situated in India" in terms of section 9(1)(i) of the Act. Therefore, the taxpayer went before the Delhi HC.

Held

The HC observed that the issue of situs of an intangible asset was a tricky issue as opposed to that of tangible assets, which had a physical presence in India. The legislature could have, through a deeming fiction, provided for the location of an intangible capital asset, such as intellectual property rights; however, it has not done so. With regard to a share or interest in a company registered/ incorporated outside India, Explanation 5 has been added to section 9(1)(i) of the Act by virtue of the Finance Act, 2012 with retrospective effect from 01 April, 1962 to provide that the *situs* of the said share or interest would be in India. There was no such provision with regard to intangible assets, such as trademarks, brands, logos, i.e., intellectual property rights. Therefore, the well accepted principle of '*mobilia sequuntur personam*' would have to be followed. The situs of the owner of an intangible asset would be the closest approximation of the *situs* of an intangible asset. This was an internationally accepted rule, unless it was altered by local legislation. As noted above, there was nothing in the Indian laws providing for the same. The HC therefore held that the income accruing to the petitioner from transfer of its right, title or interest in and to the trademarks etc. was not taxable in India under the Act.

Editor's note

The HC's overruling of the AAR on the above issue is a welcome relief in the context of cross-border acquisition transactions which involve transfer of intangible property used in India by Indian affiliates of multinational companies.

It will be useful to draw attention to the observations of the Delhi HC in an earlier landmark decision issued in March 2015 (which was in the context of the marketing intangibles issue for distributors) where the HC had observed that economic ownership of a brand was an intangible asset, just as legal ownership, and that brand valuation would be mandated when economic ownership got transferred to a third party. The HC did not specifically discuss where the economic ownership was located.

It would have helped if the Delhi HC, while arriving at its conclusion, had discussed a wealth-tax circular providing contrary guidance on the location of intangible assets. The circular stated that copyright or licence to use any copyrighted material, patent, trade mark, or design were located in India if the rights arising therefrom were exercisable in India, and that patents, trademarks and designs were located in India if they were registered in India.

Revenue expenditure

Share application money not share capital, interest thereon a revenue expenditure

S.R. Thorat Milk Products Private Limited, MZSK & Associates *v.* ACIT [ITA Nos. 1533 to 1537/ PN/ 2014 (Pune-Tribunal)]

Share application money received from shareholders' pending allotment could not be characterised as or equated with share capital. Accordingly, the payment of interest on such share application money that had been utilised for business purposes was a revenue expenditure.

Facts

The taxpayer was a closely held company (the Company), engaged in the business of processing of milk and manufacturing of milk products. During FY 2003-04 to FY 2008-09, the Company had received share application money from existing shareholders from time to time. In the FY 2003-04, the Company decided that since the shares could not be allotted within a reasonable time frame, the money had to be refunded along with interest @ 12 percent per annum. Accordingly, as and when the share application money pending allotment was refunded to the shareholders, interest @ 12 percent per annum was also paid after deducting appropriate taxes at source. The taxpayer claimed the interest paid to the shareholders on the share application money as a revenue expense. The TO disallowed the interest paid on share application money, stating that such interest was allowable neither under section 36(1)(iii) nor under section 37(1) of the Act. The TO held that the following ingredients of borrowing by the taxpayer were not present when interest was paid on receipts in the nature of share application money:

- a positive act of lending by one and expense thereof by the other;
- an obligation of refund or repayment thereof.

The TO, relying on the decision of the SC in the case of Punjab State Industrial Development Corporation Limited *v.* CIT [1997] 225 ITR 792 (SC) and Brooke Bond India Limited *v.* CIT [1997]140 CTR 598 (SC), held that the expenditure on account of interest paid on share application money was not revenue but a capital expenditure, and was not allowable under section 37(1) of the Act. Further, in the absence of any act of borrowing, the conditions prescribed under section 36(1)(iii) of the Act were not fulfilled. The TO disallowed the interest paid on share application money in the taxpayer's hands. Aggrieved by the TO's order, the taxpayer filed an appeal before the CIT(A) and argued that the share application money was used for business purposes, and that the same could not be characterised as share capital until actual allotment. The CIT(A) endorsed the TO's finding. Aggrieved by the CIT(A)'s order, the taxpayer filed an appeal before the Tribunal in respect of the TO's disallowance of interest paid on share application money.

Held

The Tribunal, relying on the decision in ACIT *v.* Rohit Exhaust Systems Private Limited ITA No. 686/ PN/ 2011 and ITA No. 687/ PN/ 2011 (Pune-Tribunal), held that the share application money *per se* could not be characterised as and equated with share capital and allowed the interest paid on share application money to revenue expenditure. It agreed with the taxpayer's contention regarding the obligation to return money being implicit in the event of non-allotment of shares, and the argument that share application money was not held towards share capital, and if it had been utilised for business purposes, interest paid thereon until allotment was a revenue expenditure.

Editor's note

From the above ruling, the following interesting points emerge:

- *Share application money cannot be characterised as share capital until allotment, and is in the nature of debt owed.*
- *The interest paid on share application money used as working capital for business purposes has been held as revenue in nature. This judgment is for a period under the old Companies Act, 1956, applicable to a closely held company. Reasons for delay in allotment of shares have not been discussed, nor has the issue of the arm's length nature of the transaction been analysed. It will be interesting to see how the ratio of this case can be applied in future under the new Companies Act, 2013 and the prescribed rules for allotment of shares and refund of share application money.*

Non-discrimination

Transfer of Indian branch, in foreign company amalgamation, held not liable to tax in India as section 47(vi) benefit allowed to foreign company applying non-discrimination clause in tax treaty

AAR No. 1130 of 2011

Amalgamation resulted in the transfer of the Indian branch of the amalgamating Italian company; however, in absence of receipt of consideration by such company, capital gains

could not be computed, and tax could not be charged under the provisions of the Act;

- *In view of the non-discrimination clause in the India-Italy tax treaty, the amalgamating Italian company was entitled to claim that any transfer in amalgamation was not liable to tax under the Act; and*
- *In view of the tax treaty, capital gains arising to the shareholders on transfer of the shares in the amalgamating company would not be liable to tax in India.*

Facts

The applicant owned about 14.96 percent shares in X, a company, resident in Italy. The applicant and X were part of the Z group that was engaged in banking and financial services operations in India through Y, an Indian company. X set up an Indian branch in January 2010 and acquired the information technology business of Y on slump sale basis on 15 February, 2010 for INR 130.6 million. The Indian branch did not hold any immovable asset in India. Pursuant to a group restructuring, X was amalgamated with the applicant with effect from 30 May, 2011. Consequently, the Indian branch of X became the branch of the applicant. The shareholders of X, other than the applicant, were issued shares of the applicant. Total cost of the Indian branch was 5.75 percent of the total cost of assets of X. The transfer of shares of X would result in indirect transfer of the Indian branch only if such shares derived substantial value from the Indian branch. The applicant sought a ruling on various issues.

Held

The Explanatory Notes to Finance Act, 1967 clarified that tax liabilities were attracted in case of both, amalgamating company and shareholders. It was held that in amalgamation, there was transfer of the Indian branch of X. However, in the absence of consideration, the computation mechanism failed, and thus capital gains, on such transfer, could not be computed. Further, the fair value of assets transferred could not be treated as consideration.

Article 25(1) of the tax treaty meant that there should be no discrimination on the basis of nationality, and no preferential treatment should be given to local taxpayers. Article 25(3) dealt with “personal allowance etc.”, that could apply to individuals, and not to companies. If amalgamation resulted in benefit to domestic companies and its shareholders, there was no reason to deny the same to the foreign company and its shareholders. Therefore, exemption under section 47(vi) should have been available to X.

Based on the judgement of CIT *v.* Grace Collis [2001] 248 ITR 323 (SC), the extinguishment of shares in X was a transfer liable to capital gain tax. In case of transfer of shares by the applicant, in the absence of consideration, the computation mechanism failed, and capital gains could not be computed. The tax was chargeable on real capital gain and not on notional gains. Notional market value of the asset could not be treated as consideration.

In relation to indirect transfer, “substantial” would mean at least 50 percent. However, even in such a case, in the absence of consideration, capital gains could not be computed and charged to tax. Shareholders of X had parted with shares in X, and not the movable property of the Indian branch. Therefore, the tax treaty provision relating to PE would not be applicable, but provisions relating to transfer of shares should have been applied. Based on the provisions of article 14(5) of the tax treaty, capital gains resulting from the transfer of shares should not have been subjected to tax in India. Transfer pricing provisions were not applicable, because there was no chargeability to tax.

Editor’s note

This ruling reiterates the basic principle that in the absence of consideration, capital gains cannot be computed and taxed. The ruling also provides clarity on the applicability of the non-discrimination clause in the tax treaty.

Capital asset

Call option right on shares for an ‘incredibly long period’, is a valuable right and a separate class of asset distinct from the shares

Praful Chandaria *v.* Add. DIT [(2016) 73 taxmann.com 14 (Mumbai-Tribunal)]

Where a “call option” had been given for an ‘incredibly long period’ amounting to perpetuity, along with an irrevocable POA authorising the option buyer to exercise all the rights of a shareholder, such call option would

be treated as a capital asset, and transfer thereof would be chargeable to capital gains tax.

Facts

The taxpayer was a tax resident of Singapore. The taxpayer held 99 percent shares in P Limited, an Indian company. The balance shares in P Limited were held by two directors of the company. B Limited was another Indian company in which P Limited held 25 percent of the share capital and H Mauritius held the remaining 75 percent. The taxpayer and the other two shareholders of P Limited entered into a "call option agreement" (agreement 1) with H Mauritius to sell, in relation to their shareholding in P Limited. P Limited also entered into another "call option agreement" (agreement 2) with H Mauritius to sell the shares held by it in B Limited to H Mauritius. The right of the "call option" under both the agreements was to be exercised within a period of 150 years. On exercise of the option under agreement 1, the shareholders of P Limited were obliged to transfer their shareholding at an exercise price of US$1. Similarly, on exercise of the option under agreement 2, P Limited was obliged to transfer shares in B Limited at an exercise price of Rupee one. The consideration for grant of option under agreement 1 was US$2,450,000. The taxpayer had provided an undertaking stating that having received the consideration, a Power of Attorney (POA) would be executed in favour of ING Bank NV in respect of shares held in P Limited, and that he would not, at any time, revoke the undertaking. In the said POA, the taxpayer had irrecoverably nominated and given powers to ING Bank NV to attend all meetings of P Limited in relation to his shareholding therein. The taxpayer had also agreed that he would not transfer the shares held in P Limited by means other than those mentioned in agreement 1.

Held

Under an ordinary call option, only the right to buy the shares at a strike price within a stipulated time period would have been given, which may not have been termed as capital asset under section 2(14) of the Act, because without exercise of the option, no actual asset was created. In the given case, the period of time for exercising the call option had been fixed at 150 years. This "incredibly long period" meant that the call option in the shares had been given for perpetuity. In addition, the rights that could be enjoyed by the shareholder had been exercised by the POA holders pursuant to the POA. The execution of the POA revealed that the taxpayer had alienated a substantive and valuable right as the owner of the shares without transferring the shares themselves. Such a call option in the shares had to be reckoned as a valuable and substantive right, which would be a class of asset separate from the underlying shares that continue to stand in the taxpayer's name. Such a call option in the shares would certainly be a "capital asset," and parting with such call option would surely be reckoned as transfer of a capital asset, liable to tax as capital gains. In case of a non-resident, taxing any income accrued or arising in India had to be seen from the perspective of the tax treaty. Moreover, as per Article 13(6) of the tax treaty, the capital gain on transfer of property arising to a resident of Singapore could be taxed only in Singapore, and could not be held to be taxable in India. Therefore, the addition made by the TO was deleted.

Editor's note

The Tribunal has confirmed that rights in shares can also be capital assets separate from the underlying shares. The Tribunal has reiterated that in determining the nature of capital asset, sufficient weightage needs to be given to the terms and conditions attached to such call/ put options in share purchase/ joint venture agreements. If an option is granted for a considerably large period, coupled with the transfer of substantive rights in the shares, it may be treated as transfer/ alienation of a property, thereby resulting in capital gains.

Section 45(3) is not applicable to land, held as stock-in-trade, contributed by a partner in a partnership firm

ITO *v.* Orchid Griha Nirman Private Limited [2016] 74 taxmann.com 187 (Kolkata)

Section 45(3) is applicable only in respect of a capital asset contributed by the partner in the partnership firm. Where the partner (taxpayer) had contributed land that was purchased and held as stock-in-trade to the partnership firm, section 45(3) of the Act was not applicable, and no capital gains would arise on such transfer.

Facts

Pursuant to a registered deed of sale executed on 30 March, 2005, the taxpayer, along with two other companies had purchased land with the objective of developing an industrial park. The land was accounted for by the taxpayer as work in progress and was reflected under the head "current assets" in the balance sheet. On 09 January, 2006, the taxpayer, along with other land owning companies and a developer, formed a partnership firm (the Firm) and contributed the land at cost as capital contribution. The Firm accounted the said land as work in progress and reflected it under current assets in the balance sheet as on 31 March, 2006. The Firm obtained a bank loan of INR2.5 billion. The Firm carried out development on the land and constructed an industrial park thereon. The industrial park was ready by the end of March 2008. On 30 March, 2008, the Firm converted the land and building into fixed assets. On 31 March, 2008, the land and building were revalued to reflect the market value of the land and building to justify the bank loan of INR2.5 billion. The revaluation amount was credited to the partners' current accounts in their profit sharing ratio. The partners had withdrawn amounts almost equal to the cost of the land contributed by them and credited to their account. The Firm let out the developed project to various parties and did not sell any part thereof. The TO considered the revaluation amount credited to the partners' current account for determining the capital gains arising on transfer of capital asset under section 45(3) for the AY 2008-09. The CIT(A) rejected the TO's view.

Held

The partners transferred the said land at cost. As such, there was no profit in the hands of the partners upon transfer of the said land to the said firm under section 45(3). Section 45(3) of the Act was applicable only in respect of a capital asset and not in case of the transfer of an asset that was not a capital asset. Section 45(3) was applicable in the year of transfer of capital asset and not at the time of conversion or revaluation of such land, and as the capital contribution was made during the FY 2005-06, the TO was not justified in invoking section 45(3) in AY 2008-09. Additionally, section 45(3) seeks to determine capital gains with reference to the value of the asset recorded in the Firm's books of account, and not to substitute any other figure for the value agreed between the partners. Relying upon the SCs decision in the case of Sanjeev Woollen Mills *v.* CIT [2005] 279 ITR 434 (SC), it was held that the valuation of asset at market value, which was higher than the cost, resulted into notional profits that were not actually received, and such imaginary/ notional profits could not be taxed. The taxpayer's source of income was its share in the Firm's income. Even assuming that the revaluation amount was taxable in the Firm's hands, the taxpayer's share in such income would be exempt under section 10(2A) of the Act. The CIT(A)'s order was upheld, and the TO's appeal dismissed. It was held that the taxpayer did not make any capital gain taxable under section 45(3) of the Act in the AY 2008-09 and that the amount of revaluation of its fixed assets by the Firm was not taxable in the taxpayer's hands.

Editor's note

The Tribunal held that section 45(3) was not applicable to contribution of stock-in-trade. However, the Delhi Tribunal's (DLF Universal Limited v. *DCIT [2010] 36 SOT 1 (Delhi-Tribunal)] decision holding that section 45(3) was applicable even if stock-in-trade was contributed, was not considered in this decision. The Tribunal has also reiterated that the notional gain resulting from revaluation of assets is not liable to tax.*

Retrospective impact of beneficial amendment

Amendment introduced to remove undue hardship to taxpayer or to remove an apparent incongruity ought to be treated as retrospective

Dharamshibhai Sonani *v.* ACIT [ITA No. 1237/ Ahd/ 2013 (Ahmedabad-Tribunal)]

Amendment for the rationalisation of section 50C to provide relief when sale consideration was fixed under agreement to sell should have taken effect retrospectively.

Facts

The taxpayer, along with other co-owners, owned certain agricultural land. On 29 June, 2005, the taxpayer entered into

an agreement to sell certain land for a consideration of INR4.5 million. The buyer, a private company, could not have purchased the agricultural land unless it was converted to non-agricultural land. The taxpayer sought this conversion before the execution of the sale deed. The sale deed for said land was therefore executed on 24 April 2007, after such conversion. The stamp duty valuation on 24 April 2007, was INR7.621 million. The TO made an addition to the sales consideration based on such valuation of INR7.621 million. The CIT(A) upheld the TO's decision.

Held

The fundamental purpose of introducing section 50C was to counter the suppression of sale consideration on the sale of immovable properties. Section 50C provided for a presumption that the value adopted for the purpose of stamp duty computation fairly represented the market price of the property. The trouble arose in a situation in which there was considerable time gap between the date of the agreement to sell and the date of the sale deed, because the consideration was fixed at the time at which the agreement to sell was entered; however, for the purpose of computing capital gains, the value as on the date of execution of sale deed was recognised by section 50C. This comparison of consideration fixed on the date of agreement to sell and stamp duty valuation on date of sale deed was devoid of a rational basis, because they represented the values at two different points of time. In such a situation, the comparison should ideally be made between the sale consideration as per the agreement to sell and the stamp duty valuation as on that date. This was because the sale consideration was fixed at the time of agreement to sell. To rationalise the above incongruity, section 50C(1) was amended to provide that in situations such as the above, the stamp duty valuation on the date of agreement may be considered for the purpose of computing the full value of consideration for such a transfer. The proviso applied only in cases in which a whole or part of the consideration had been received on or before the date of the agreement to sell. The amendment would be in effect from 01 April, 2017. It was not disputed that the amendment had been introduced to remove undue hardship to the taxpayer, or remove any apparent incongruity, and that such an amendment should have been treated as being effective from the date on which the law containing such provision to remove undue hardship or incongruity was introduced. A curative amendment was to be treated as retrospective in nature even though it may not state so specifically (CIT *v.* Ansal Landmark Township Private Limited [2015] 377 ITR 635(Delhi) and CIT *v.* Alom Extrusion Limited [2009] 319 ITR 306 (SC)). The amendment to section 50C, being an amendment to remove the apparent incongruity that resulted in undue hardship to the taxpayers, should have been treated as retrospective in effect, and have been effective from 01 April, 2003, i.e., from the date of introduction of section 50C. The matter was directed back to the TO to verify both, the execution of the agreement to sell on 29 June, 2005, and the receipt of consideration on or before that date and, if found to be in order, to compute the capital gains based on stamp duty valuation as on 29 June, 2005, *viz.*, the date of the agreement to sell. It was observed that the application of the proviso, adopting valuation as on the date of agreement to sell instead of valuation as on the date of the sale deed, was at the option of the taxpayer.

Editor's note

The Tribunal has reiterated that when an amendment has been introduced in order to remove hardships caused to taxpayers due to the provisions of the statute, the amendment must be given a retrospective effect, even without a specific provision to that effect. The Tribunal has also clarified that the application of the amended provisions is not mandatory, but at the option of the taxpayer. In the situation of falling real estate prices, this observation will provide relief to taxpayers.

Non-compete fee

Allocation of part of consideration for transfer of shares towards non-compete fee held not justified

ACIT *v.* Sanjay Umesh Vyas [ITA No. 3963/ Mum/ 2011]

Total consideration received by the taxpayer from sale of shares was the "full value of consideration" for computation of capital gain, and no part of such consideration should have been attributed towards non-compete fees.

Facts

The taxpayer was a promoter and director in a private company. The company was engaged in the business of software training. The taxpayer and Mr. A were shareholders of the company with 50 percent share each. The taxpayer sold 28,421 shares (being 70 percent of his shareholding) to B Limited *vide* share purchase and subscription agreement (SPSA). The 28,421 shares were sold for INR17.5 million, that is, at INR615.75 per share, resulting in long-term capital gain of INR4.185 million. Mr. A also sold 70 percent of his shares at the rate of INR 615.75 per share. B Limited made further investment in the company at the same rate of INR 615.75 per share. The taxpayer had entered into a separate arrangement for managing the operations of the company in the name of "continuity incentive" and "engagement contract" and was sufficiently compensated under those agreements. The TO took the view that the sales consideration of INR17.5 million was inclusive of non-compete compensation liable to tax as his business income under section 28(va) of the Act. The CIT(A) rejected the TO's stand.

Held

The term "full value of consideration received or accrued" in section 48 of the Act implied that it was the full value of consideration for the transfer of capital asset. The price for transfer was arrived at after due negotiations between both parties. Therefore, there could not have been any question of applying a lower market price to determine the sale consideration. Non-compete compensation referred to in section 28(va) of the Act applied to any sum received for not carrying out any activity in relation to any business, or for not sharing any intellectual property relating to the business sold or transferred. In the instant case, the taxpayer was not restricted from carrying out any activity. In fact, the taxpayer was actively engaged in the day-to-day business affairs, for which he was being adequately compensated. The non-compete clause was in the nature of a standard condition in SPSA that could not form the basis for allocating part of consideration towards non-compete compensation. Therefore, the total consideration received by the taxpayer from sale of shares should have been treated as full value of consideration in the computation of capital gain, and no part of the said consideration could be attributed towards non-compete compensation.

Editor's note

The Tribunal concluded that if the transfer of shares is at fair value, the allocation of a portion thereof to non-compete compensation by considering the transfer of shares to be at less than fair value, was not justified.

Depreciation

Separate purchase of brand followed by merger of the seller company with purchaser held not to be a colourable device – depreciation allowed on brand

DCIT *v.* M/s. Emerald Jewel Industry India Limited [ITA No. 1811/ Mds/ 2015 (Chennai-Tribunal)]

When the taxpayer acquired the brand for an agreed consideration from an associate company, it could not be denied depreciation on such brand only because such associate company was subsequently merged with the taxpayer through a scheme of amalgamation (Scheme).

Facts

The taxpayer was engaged in the business of manufacturing and sale of gold and diamond jewellery. The taxpayer acquired brand 'A' from A Limited, which was an associate company of the taxpayer, for a consideration of INR83.8 million. A Limited was merged with the taxpayer with effect from 31 December, 2009 through a Scheme, post purchase of the brand 'A' by the taxpayer. The taxpayer claimed depreciation on the cost of brand 'A'. In the assessment for AY 2011-12, the TO held that the purchase of the brand and subsequent merger was a colourable device for reducing tax by claiming depreciation on the brand value, and therefore, disallowed depreciation on the brand cost. Similar disallowance was made in AY 2010-11 as well; however, the taxpayer did not appeal against it. The CIT(A) confirmed the TO's order.

Held

The taxpayer and A Limited, though associate companies, were separate and independent entities. It was undisputed that the taxpayer had paid INR83.8 million for purchase of brand 'A' from A Limited. A Limited was amalgamated with the taxpayer, and the taxpayer claimed to set-off losses of A Limited against the profit earned by it. Merely because the set-off had been claimed by A Limited could not be a reason to disallow the taxpayer's claim for depreciation. Section 32 of the Act specifically provides that brand name is an asset eligible for depreciation. Further, the Revenue did not dispute the payment for the cost of the brand. Regarding the taxpayer's claim that the brand was acquired outside the Scheme and the payment had also been made, it was held that such claim could not be doubted, especially when the fact of payment was not in dispute. A Limited had several intangible assets apart from the brand name that might have been transferred through the Scheme. Subsequent amalgamation could not be construed as a device as the taxpayer had not acquired any brand before that. When the brand was acquired on payment of consideration before amalgamation, the taxpayer was eligible to claim depreciation. The Tribunal could study the merit of the claim, irrespective of the TO's order, for the earlier AY that was not challenged by the taxpayer. The fact that the taxpayer had not challenged the earlier order could not be a reason for the Tribunal to reject the taxpayer's claim in the subsequent year. Therefore, the taxpayer was eligible for depreciation on the brand acquired on payment of the consideration.

Editor's note

This is an important ruling stating that two separate and completed transactions, which are not otherwise disputed, cannot be considered a colourable device and treated as a single transaction. The Tribunal also reiterated the non-applicability of the principle of res judicta *to assessments, meaning that not challenging the assessment for one year cannot be a bar on challenging an assessment made on the same grounds in any other year.*

Non-compete right held to be an intangible asset eligible for depreciation

Sangeetha Mobiles Private Limited *v.* ACIT [ITA No. 1185 & 1186 of 2016 (Bangalore-Tribunal)]

Payment made by the taxpayer towards non-compete right was towards acquiring an intangible asset eligible for depreciation.

Facts

The taxpayer acquired tangible assets, trademarks and other assets through an asset purchase agreement for an aggregate consideration of INR0.13 billion. The taxpayer allocated INR18 million towards depreciable tangible assets, INR7 million towards other assets, and the balance INR105 million towards goodwill, and claimed depreciation on tangible assets and goodwill. It was also agreed between the taxpayer and the seller that the seller would not do anything for 12 months that could be deemed to be in competition with the taxpayer's business. The TO treated the amount of INR105 million to be payment towards non-compete agreement, and not as payment for acquisition of goodwill, and disallowed the depreciation thereon.

Held

The taxpayer had the right to enforce the performance of the agreement terms, restricting the seller from competing with it. Hence, the right could be said to be transferable. The facts of the taxpayer's case were similar to those in the case of M/s. Ingersoll Rand International [2014] 48 taxmann.com 349 (Karnataka), and could not be distinguished. Therefore, the Tribunal ruled that the non-compete right was an intangible asset, and that the taxpayer was eligible to claim depreciation thereon. In view of this, it was academic whether such rights were treated as goodwill or non-compete fees.

Editor's note

The Tribunal has reiterated that payment for non-compete rights is an intangible asset within the meaning of section 32(1)(ii), and is eligible for depreciation thereunder. This view is supported by the decision in the case of Ingersoll Rand International. It is important to note that in the case of Sharp Business Systems [2012] 254 CTR 233 (Delhi), the Delhi HC had ruled that the non-compete right was not an

intangible asset within the meaning of section 32(1)(ii). The Tribunal has observed that the decision of the Delhi High Court was on the basis that the non-compete rights cannot be transferred to any other person. This observation should be considered while drafting the agreement.

Tribunal upheld application of Explanation 3 to section 43(1) in case of improper allocation of purchase consideration

Sanyo BPL Private Limited *v.* DCIT [ITA No. 1395/ Bang/ 2014 (Bangalore-Tribunal)]

The Tribunal upheld the disallowance of allocation of purchase consideration to depreciable assets received as a part of business acquired on slump sale basis, applying Explanation 3 to section 43(1) of the Act.

Facts

The taxpayer was a joint venture between S Limited holding 50% and B Limited holding 50%. The taxpayer acquired a colour television business from B Limited (transferor) on a slump sale basis for a consideration of INR3.6 billion under a business transfer agreement dated 14 December, 2005. The taxpayer accounted for the assets acquired by allocating the purchase consideration to each asset on the basis of the fair value of the respective assets as determined by an independent valuer. The taxpayer attributed INR442.9 million to the cost of acquisition of a “distribution network” and claimed depreciation @12.5% (for less than 180 days) as applicable on intangible assets. As per the report, a value of INR738.4 million was attributed to tangible depreciable fixed assets, and INR62.2 million was attributed to land. The closing written down value (WDV) of the tangible depreciable assets in the hands of the transferor was INR157.5 million. Thus, there was an increase in the depreciable amount to the extent of INR580.9 million. However, the TO disallowed the entire depreciation of INR55.4 million on the distribution network, invoking Explanation 3 to section 43(1) of the Act, the TO also disallowed a part of the depreciation claimed on other tangible depreciable fixed assets. The CIT(A) upheld the TO’s decision.

Held

Even assuming that there was no asset such as a distribution network, any excess consideration was goodwill entitled to the depreciation allowance. The law was fairly settled to that extent. However, in case of dispute between taxpayer and the Revenue, the Revenue has ample power to determine the actual cost for computation of depreciation. The taxpayer had failed to controvert the TO’s finding as to inflation of the actual cost of the assets. In these circumstances, the TO would be justified in inferring that the asset was fictitiously priced to avail higher depreciation. In any event, the right to use a distribution network did not result in creation of any intangible asset. Thus, the TO was justified in disallowing the depreciation on the distribution network. The Tribunal held the taxpayer’s claim to be an ingenious attempt and a colourable device to claim higher depreciation and avoid tax. As regards depreciation on tangible depreciable fixed assets, the Tribunal held that all the ingredients of applying Explanation 3 to section 43(1) *viz.*, (i) asset being previously used by other person, and (ii) transfer effected to reduce tax liability, were satisfied. Explanation 3 required that the TO determine the actual cost with the approval of the joint commissioner, which was also obtained. Although the valuation report was obtained, a lesser value was assigned to the land and a higher value was assigned to the depreciable assets. Therefore, the TO was justified in ignoring the valuation report and invoking Explanation 3 to section 43(1).

Editor’s note

Explanation 3 to section 43(1) of the Act is applicable if the main purpose of transfer is the reduction of tax liability. The Tribunal has held that all the conditions laid down in Explanation 3 to section 43(1) of the Act are complied with, without any specific finding proving the main purpose to be reduction in tax liability. The Tribunal has reiterated that the excess consideration paid in relation to a slump sale is to be considered as goodwill, eligible for depreciation. However, while the application of Explanation 3 is upheld, total consideration is not reallocated on all assets, treating the balance, if any, as goodwill.

Notifications and circulars

Corporate social responsibilities

FAQs with regard to CSR under section 135 of the Companies Act, 2013

General Circular No. 01/ 2016 dated 12 January, 2016

The Companies Act, 2013 along with the Companies (Corporate Social Responsibility Policy) Rules, 2014 (CSR Rules) mandate and regulate social spending by companies. The MCA had previously issued General Circular No. 21/ 2014 dated 18 June, 2014 to provide clarifications on the provisions of CSR under section 135 of the Companies Act, CSR Rules, and the activities to be undertaken as per Schedule VII of the Companies Act. In response to further queries received, the MCA has recently issued General Circular No. 01/ 2016 on FAQs to provide clarity on various issues pertaining to the CSR provisions. The FAQs relate to applicability of provision, computation of CSR spending, tax deductibility of CSR spending, nature of activities to be covered as CSR spending, reporting requirements, carry forward of excess/ shortfall in CSR spending, inclusion of non-monetary transactions etc.

Editor's note

The CSR obligations of a corporate entity are continuing obligations. With these FAQs, the MCA has reiterated the intent and commitment of the government towards smooth implementation of the CSR provisions.

Combination provisions

Enhanced threshold limits for, and exemption from applicability of, combination provisions under the Competition Act, 2002 notified

In 2011, the MCA had exempted certain enterprises from application of combination regulations under section 5 of the Competition Act, 2002 (the Act) for five years. These exemptions expired on 03 March, 2016. The MCA had also revised the threshold limits for applicability of the above provisions. On 04 March, 2016, the MCA issued a notification exempting certain enterprises for a further period of five years, and also notified revised threshold limits for applicability of these provisions.

A comparative chart of erstwhile and new notifications:

Particulars	Old notification	New Notification
Threshold limits [Notification No. 675(E)] (1)	Value of asset/ turnover thresholds under section 5 of the Act increased by 50%	Value of asset/ turnover thresholds under section 5 of the Act increased by 100%
Quantum based exemption [Notification No. 674] (2)	Exemption provided for five years to enterprises having Total assets in India < 2.5 billion; or Total turnover in India < 7.5 billion	Exemption provided for five years to enterprises having Total assets in India < 3.5 billion; or Total turnover in India < 10 billion
Group exemption [Notification No. 673(E)] (3)	Group exercising less than 50% voting rights in other enterprise is exempted for five years	No change – extended for a period of five years

Revised threshold limits under section 5 of the Act:

Particulars	Assets in India	Turnover in India	Assets in India or outside India	Turnover in India or outside India
Aggregate for acquirer and target	> INR20 billion	> INR60 billion	> US$1 billion including minimum INR10 billion in India	> US$3 billion including minimum INR30 billion in India
Group post-acquisition	>INR80 billion	> INR240 billion	> US$4 billion Including at least INR10 billion should be in India	> US$12 billion Including at least INR30 billion should be in India

Editor's note

The increase in the monetary threshold and extension of exemption for further five years are welcome changes, and will result in greater headroom for larger acquisitions with lesser compliances. This will further reduce the timelines for acquisitions with lower thresholds, thereby resulting in greater ease of doing business in India.

Conversion of shares

CBDT notifies rule to clarify that the pre-conversion period is includible in period of holding of shares acquired on conversion of debentures/ bonds into shares

Notification No. 18/ 2016 dated 17 March, 2016

The CBDT has notified a new rule, Rule 8AA, to prescribe the method for determination of period of holding of capital assets, being shares or debentures acquired by the taxpayer on conversion of bonds, debenture, debenture-stock or deposit certificates in any form. The computation of period of holding is relevant for determination of nature of capital gain, i.e., whether short term gain or long term gain. As per the new rule, the period for which bond, debenture, debenture-stock or deposit certificate, was held by the taxpayer prior to conversion shall be considered for determining the period of holding of such shares or debentures acquired upon conversion. The new rule shall be effective from 01 April, 2016.

Editor's note

As per the Income-tax Act, 1961 conversion of bond, debenture, debenture-stock or deposit certificate into shares or debentures is not considered as transfer. Furthermore, it is specifically provided that the cost of acquisition of shares or debentures acquired on conversion shall be the same as that of such instruments. However, there was no provision regarding the determination of period of holding of such shares or debentures that were acquired upon conversion of the aforementioned instruments. The same had led to much litigation in the past. The rule notified by the CBDT has provided certainty in the matter of determining the period of holding on conversion of such convertible instruments, and will reduce litigation in this matter.

Indirect transfer

Computation of income attributable to indirect transfer of assets and reporting thereon

Notification S.O. 2226(E) dated 28 June, 2016

Income arising from transfer of share or interest in a company or entity incorporated or registered outside India, is taxable in India if such share or interest derives substantial value from assets located in India (*section 9(1)(i) of the Act*) (such company/ entity is referred to as "Foreign Company" and such transfer is referred to as "indirect transfer of assets"). The CBDT has issued the final rules (the draft rules were issued on 23 May, 2016) for determination of the FMV of assets (tangible or intangible) and the income attributable to assets located in India for the purpose of taxation of indirect transfer of assets. The rules also deal with related reporting requirements and document maintenance obligations in relation to the same. The final rules will be effective from the date of their publication in the official gazette.

The transferred asset is considered to derive its value substantially from assets located in India if the FMV of the assets, of the Foreign Company, located in India exceeds INR100 million, and constitutes at least 50 percent of the FMV of the total assets of the Foreign Company [*Explanation 6 to section 9(1)(i) of the Act*].

Further, section 285A of the Act requires an Indian company/ entity through/ in which the Foreign Company holds assets in India (Indian Concern), to furnish information in the prescribed manner.

The final rules broadly cover the following areas:

- computation of the FMV of the various classes of assets (Rule 11UB)
- computation of income attributable to assets in India (Rule 11UC)
- information and documents that are required to be furnished by an Indian Concern (Rule 114DB)

Computation of income attributable to assets in India (Rule 11UC)

The income attributable to indirect transfer of assets shall be determined on the basis of the following formula: $A \times {}^{B}/_{C}$ where:

A= Income from indirect transfer of assets

B= FMV of the Indian assets on the specified date (as defined in Explanation 6 to section 9(1)(i) of the Act which means (i) date on which the accounting period preceding the date of transfer ends or (ii) date of transfer if the book value of assets has increased by >15 percent as compared to such value as on date referred to in (i))(computed in terms of Rule 11UB as elucidated hereunder) as compared to such value as on date referred to in (i))(computed in terms of Rule 11UB as elucidated hereunder)

C= FMV of all the assets of the company or entity as on the specified date (computed in terms of Rule 11UB as elucidated hereunder)

If the transferor fails to provide information to apply the abovementioned formula, then such income should be as determined by the assessing officer as he deems fit.

The transferor needs to obtain an accountant's certificate in Form 3CT, providing the basis of apportionment in accordance with the aforementioned formula, and certifying that the income attributable to assets located in India is correctly computed. Form 3CT contains information such as details of consideration received, cost of acquisition, date of transfer, value of assets located in India and value of global assets as well as method used to compute the same, income attributable to assets located in India, documents and valuation report (if any) relied upon, assumptions (if any), etc.

Computation of FMV (Rule 11UB)

Rule	Nature of asset	Manner of computation of FMV
B = FMV of Indian assets (for Rule 11UC)		
Proviso to 11UB(2)	Shares of a listed Indian company held as a part of the shareholding, conferring directly or indirectly any right of management or control	FMV = (A+B)/ C, where A= market capitalisation of the Indian company based on the Observable Price (Refer Note i); B= book value of liabilities (Refer Note ii) of the company on the specified date; C= the total number of outstanding shares
11UB(2)	Shares of a listed Indian company which is listed as on the specified date (other than shares those covered in proviso above)	FMV = Observable Price (Refer Note i)
11UB(3)	Unlisted shares	FMV as determined by a valuation report (Refer Note iii) as increased by the value of the liability, if any, considered in such determination

Rule	Nature of asset	Manner of computation of FMV
11UB(4)	Interest in a partnership firm or in an AOP	Step 1 – Computation of value of partnership firm on the basis of a valuation report (Refer Note iii) as increased by the value of the liability if any considered in such determination Step 2 – Value determined Step 1 to be apportioned to the extent of capital of partnership firm or AOP in the ratio of partner's capital contribution Step 3 – Balance value to be apportioned on the basis of asset distribution ratio on dissolution of partnership firm/ AOP or in absence thereof, in the profit sharing ratio Step 4 – FMV of interest in partnership firm/ AOP = Value as per Step 2 + Value as per Step 3
11UB(5)	Any other asset	Value as determined on the basis of valuation report (Refer Note iii) as increased by the value of the liability, if any, considered in such determination

It is clarified that for determining the FMV of shares of an Indian company or interest in partnership firm/ AOP, all the assets/ business operations of the company/ partnership firm/ AOP shall be taken into account even if such assets/ business operations are located outside India.

Rule	Nature of asset	Manner of computation of FMV
C = FMV of all the assets of the Foreign Company (for Rule 11UC)		
11UB(6)(i)	In case of transfer between persons who are not connected persons (as defined in section 102(4) of the Act for the purpose of application of GAAR)	FMV = A+B, where A = market capitalisation of the Foreign Company computed on the basis of the full value of consideration; B = book value of liabilities (Refer Note ii) as certified by a merchant banker/ accountant (Refer Note iv)
11UB(6)(ii)(a)	In case of transfer of share of a Foreign Company listed on the stock exchange between connected persons	FMV = A+B, where A = market capitalisation of the Foreign Company based on the Observable Price (Refer note i) B = book value of liabilities (Refer note ii) of the company or the entity on the specified date

Rule	Nature of asset	Manner of computation of FMV
11UB(6)(ii)(b)	In case of transfer of share of a Foreign Company not listed on any stock exchange between connected persons	FMV = A+B, where A = FMV of the Foreign Company as on the specified date based on valuation report (Refer Note iii) B = value of liabilities of the company or the entity considered for determination of FMV in A above

Notes:

(i) "Observable Price" shall be the higher of the average of the weekly high and low of the closing prices for six months preceding the specified date, or two weeks preceding the specified date quoted on the stock exchange where the highest volume is traded.

(ii) "Book Value of the Liabilities" = Value of liabilities as shown in the balance-sheet excluding the paid-up equity capital or members' interest and the general reserves and surplus and security premium related to the equity shares.

For this purpose, balance sheet means:

(a) In relation to an Indian company, audited balance sheet as drawn up on the specified date.

(b) In any other case, balance sheet as drawn up on the specified date and submitted to the relevant authority outside India under the applicable law(s)

However, in both the above cases, if a balance-sheet as on the specified date is not drawn up and it is pending finalisation of accounts, the balance-sheet would mean the interim balance sheet as on the specified date and which is approved by the board of the company/ equivalent body in case of any other entity. If the interim balance sheet is used for computing the FMV, then the FMV shall be appropriately modified after its finalisation. Further, in case of specified date is the date of transfer, it means the balance sheet as on that date, as certified by an accountant.

(iii) Valuation Report means the report of a merchant banker or an accountant determining the value of assets in accordance with any internationally accepted valuation methodology.

(iv) Accountant means an accountant defined under section 288 of the Act and for the purpose of valuation of foreign assets includes any valuer recognised by the foreign government and who fulfils the following criteria:

(a) if he is a member/ partner in any entity engaged in rendering accountancy/ valuation services -

(i) the entity or its affiliates has presence in more than two countries; and

(ii) its annual receipt in the year preceding the year in which valuation is undertaken exceeds INR100 million.

(b) if the person is an individual accountant/ valuer;

(i) his annual receipt (from the exercise of such profession) in the year preceding the year in which valuation is undertaken exceeds INR10 million; and

(ii) he has professional experience of not less than 10 years.

Reporting requirements of an Indian concern under Rule 114DB

Rule 114DB provides that the Indian Concern shall electronically furnish relevant information in Form 49D within 90 days from the end of the financial year in which

any indirect transfer of asset has taken place. However, when such transfer has the effect of transferring the right of management or control in relation to the Indian Concern, the said Form shall be furnished within 90 days from the date of transaction.

Rule 114DB broadly envisages reporting details of immediate holdings company/ intermediate holding company/ ultimate holding company, holding structure, contract/ agreement for transfer of asset, financial statements of the Foreign Company/ entity, information of business operations, personnel, finance/ properties, audit reports, valuation report, etc., of the foreign entity, details of payment of tax outside India, etc.

Further, it is also provided that where there are more than one Indian Concerns of a group, any one Indian Concern designated by the group and informed to the assessing officer in writing can report on behalf of all the other Indian Concerns.

Editor's note

The much awaited final rules in relation to the indirect transfer of assets have now been notified by the CBDT, providing some degree of certainty on computation of income chargeable to tax in India. However, there is no clarity in relation to computation of income and reporting thereon for transactions concluded prior to the date of applicability of the rules.

With the notification of the final rules, the Indian Concerns would be burdened with onerous responsibility to report various details in relation to the indirect transfer. Rule 114DB provides for reporting of certain details of the Foreign Company by the Indian Concern, which the Indian Concerns cannot genuinely provide. The final rules do not provide for any relaxation for such a scenario.

Acceptance of deposit

MCA issues Companies (Acceptance of Deposit) Amendment Rules, 2016

Notification No. G.S.R. 639(E) dated 29 June, 2016

The MCA has issued the Companies (Acceptance of Deposits) Amendment Rules, 2016 on 29 June, 2016 (to be effective from the same date), amending and expanding the list of exempted deposits. These rules are summarised below.

Amendment in the existing Rule 2(1)(c)

- Under existing sub-clause (ix), compulsory convertible bonds or debentures convertible within a period of five years are included in 'exempt deposits'. Now, compulsorily convertible bonds or debentures convertible within a period of ten years are included in 'exempt Deposits'.
- Under sub-clause (xi), any non-interest bearing amount received or held in trust are included in 'exempt Deposits'. The word 'or' has been replaced with 'and' to clarify that any non-interest bearing amount held in trust is exempt from the ambit of 'Deposit'.

Amendment in the existing Rule 3 – specifying limits for acceptance of deposits from members

- In sub rule (3), limits for accepting or renewing any deposit from members of a public company has been increased from '25 percent' of the aggregate of the paid-up share capital and free reserves of the company to '35 percent'.
- For private companies, a separate limit has been prescribed for acceptance of deposits from its members. Private companies may accept from its members, deposits not exceeding 100 percent of the aggregate of the paid up share capital, free reserves and the securities premium account. For public companies, the securities premium account is not available for calculating such limits.
- Further, the company has to file details of monies so accepted from members to the Registrar in the manner as may be prescribed.

Amendment in the existing Rule 4

- Advertisement inviting deposits has to be posted on the website of the company.
- Advertisement in Form DTP-1 now contains a disclaimer paragraph.

Amendment in the existing Rule 5

An exemption has been granted from obtaining deposit insurance until 31 March, 2017, or till the availability of a deposit insurance product, whichever is earlier.

The following additional items are included in “exempt deposits” category under Rule 2(1)(c)

- Sub clause (ixa): money raised by issue of nonconvertible debentures not constituting a charge on the company’s assets, and listed on stock exchange.
- Sub clause (xii): in the course of, or for the purpose of, the business:
  - (a) Advances received towards consideration for providing future services in the form of a warranty/ maintenance contract as per written agreement/ arrangement, if the period for providing such services does not exceed the period as prevalent in common business practice, or five years from the date of acceptance of service, whichever is less.
  - (b) Amount received as an advance and as allowed by any sectoral regulator/ in accordance with directions of the government.
  - (c) Amount received as an advance for subscription towards publication, whether in print or in electronic, to be adjusted against receipt of such publications.

  If the above-mentioned amounts become refundable, due to non-availability of necessary permission required or approval required, if any, to deal in goods or provision of services for which such amount is received, it will be deemed to be a deposit on the expiry of 15 days from the day it becomes due for refund.
- Sub clauses (xv) and (xvi): Any amount received by way of subscription under Chit Fund Act or SEBI’s CIS Regulations.
- Sub clause (xvii): Amounts of INR2.5 million or more received by a start-up company by way of convertible note (convertible into equity shares or repayable within a period not exceeding five years from date of issue) in a single tranche, from a person.
  - “Start-up Company” is defined to mean a private company incorporated under the Companies Act, 2013 or the Companies Act, 1956, and also fulfilling the Start-up India Guidelines issued by the DIPP.
  - “Convertible note” has been defined to mean an instrument evidencing receipt of money initially as a debt, which is repayable at the option of the holder, or which is convertible into such number of equity shares of the start-up company upon occurrence of specified events, and as per other terms and conditions agreed to and indicated in the instrument.
- Sub clause (xviii): any amount received from SEBI-registered AIFCs, domestic venture capitalists and mutual funds.

New Rule 16A disclosure in notes to the financial statement

- In case of private companies–money received from the directors and their relatives.
- In case of other companies–money received from the director.

Institutional trading platform

SEBI releases discussion paper on review of framework for institutional trading platform

Discussion paper on review of framework for institutional trading platform

In August 2015, the SEBI had notified a simplified framework for raising of capital by technological start-ups and other companies on the institutional trading platform. Based on recommendations received, SEBI has now put forward certain proposals for discussion, which relax the requirements relating to listing on such platforms, to attract both investors and investees interested in the relevant market.

The SEBI had notified “Chapter XC – Listing on Institutional Trading Platform (ITP)” under the SEBI (Issue of Capital and Disclosure Requirements)(Fourth Amendment) Regulations, 2015 on 14 August, 2015.

These regulations provided for rules to be followed in case of listing of a specified security on the ITP.

Entities eligible for listing on the ITP would be mainly start-up companies, including those that intensively use technology, information technology and intellectual property.

However, the ITP has not received the expected response from either investors or investee companies.

Therefore, the SEBI has now released a discussion paper setting out certain proposals that further relax the eligibility and threshold requirements for companies intending to list on the ITP, and for shareholders of and potential investors in such companies.

The SEBI sought public comments on these proposed changes before 14 August, 2016. The proposals for changes to the ITP framework are enumerated in the table below.

Sr. No.	Parameter	Existing	Proposed
1	Change in title of Chapter XC	Existing name of the chapter is “Listing on Institutional Trading Platform”	The chapter may be renamed as “High-tech start-up and other new business platform”
2	Definition of “institutional investors” expanded	“Institutional investors” mean: a) Qualified Institutional Buyers (QIB) b) Family trust or systematically important NBFCs, all with net worth more than INR5 billion, as per the last audited financial statements	“Institutional investor” means: a) Qualified Institutional Buyers b) Family trust or systematically important NBFCs, all with net worth more than INR5 billion, as per the last audited financial statements c) Category III Foreign Portfolio Investors d) An entity meeting all the following criteria: – Pooled investment fund with minimum asset under management of US$150 million; – Registered with the financial service regulator in the jurisdiction in which it is a resident; and Residents of certain countries are specifically restricted in the discussion paper
3	Pre-listing shareholding	a) QIB are required to hold at least 25% of pre-issue capital of an entity that intensively uses technology, etc. b) QIB holding of at least 50% is necessary in case of any other entity.	a) Holding by QIB to be replaced by holding by institutional investor as sought to be amended above. b) Minimum pre-issue holding of 25% by institutional investor to be uniform for all companies, irrespective of sector of operation.
4	Cap on holding in the post-issue capital	No person, individually or collectively with persons acting in concert, shall hold 25% or more of the post-issue capital.	This requirement has been deleted.

Sr. No.	Parameter	Existing	Proposed
5	Allocation in net offer to public	a) 75% for institutional investors; and b) 25% for non-institutional investors (NIIs)	a) Not less than 50% to institutional investors b) Not more than 50% to NIIs
6	Discretionary allotment to an individual institutional investor	Not more than 10% of the issue size	Ceiling limit may be revised upward from 10% to 25%
7	Market making	Not mandatory	Market making may be made compulsory for a minimum period of three years for issue size of less than INR1 billion.
8	Lock-in period of pre-listing capital	Lock-in for a period of six months for all shareholders. However, such lock-in shall not apply to the following: a) Shares arising out of employee stock options; b) equity shares held by venture capital fund or Category I alternative investment fund or foreign venture capital investor; and c) equity shares held by person other than promoters.	Lock-in period of six months may apply uniformly to all categories of shareholders, without any exception.

Editor's note

According to the SEBI, there are over 3,000 companies in India that could benefit from listing on the ITP. The minimum shareholding by institutional investors of 25 percent has been extended to all sectors, thus providing other sectors with equal opportunity to enter into the ITP. The enactment of such proposals may provide the much-needed impetus for ITP to take off.

Buy-back

Final rules for determining amount received by the company on issue of shares, being subject matter of buy-back, notified

Notification No. 94 [F. No. 370133/ 30/ 2016-TPL/ GSR 982(E)] dated 17 October, 2016

Section 115QA of the Act, applicable from 01 June, 2013, provides for payment of additional income-tax by the company at the rate of 20 percent (plus applicable surcharge and education cess) on the distributed income on buy-back of unlisted shares. For the purpose of section 115QA, distributed income means the consideration paid by the company on buy-back of shares as reduced by the amount that was received on issue of such shares, determined in the manner as may be prescribed. The words, "determined in the manner as may be prescribed" have been inserted by the Finance Act, 2016 (effective from 01 June, 2016). The CBDT had earlier issued draft rules dated 25 July, 2016 considering eight different situations, for public comments. The CBDT has now notified the final rules for determining the amount received for issue of shares under 12 different situations. These rules are effective from 01 June, 2016.

Methodology of determining "amount received by the company"

Sr. No.	Situation	Amount received by the company
1.	Shares issued upon subscription by any person	The amount, including premium, actually received by the company
2.	Where the company has, prior to the buy-back of shares, returned any sum out of the sum received on issue of shares	The amount received by the company as reduced by the sum so returned. It is clarified that tax, if any, paid under section 115-O of the Act shall not be reduced to arrive at the amount received.
3.	Shares issued under ESOP or as sweat equity shares	The FMV of the share as determined by the merchant banker on the specified date, to the extent credited to the share capital and share premium account by the company. (a) "merchant banker" means Category I merchant banker registered with the SEBI (b) "specific date" means: (i) the date of exercising of the option; or (ii) any date earlier than the date of the exercising of the option, not being a date which is more than 180 days earlier than the date of the exercising)
4.	Shares are issued under a scheme of amalgamation, in lieu of the share or shares of an amalgamating company	The amount received by the amalgamating company in respect of such shares issued shall be deemed to be the amount received by the amalgamated company in respect of the shares so issued.
5.	Shares issued under a scheme of demerger	The amount that bears to the amount received by the demerged company in respect of the original shares, determined in accordance with this rule, the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.
6.	In respect of original shares of a demerged company	The amount received by such demerged company in respect of the original shares, as reduced by the amount derived under sr. no. 5 above.

Sr. No.	Situation	Amount received by the company
7.	Share issued or allotted as part of consideration for acquisition of any asset or settlement of any liability	The amount received by the company for issue of such share shall be determined as under ***Amount received = A/ B*** Where A = an amount being lower of the following: the amount which bears to the FMV of the asset or liability, as determined by a merchant banker, the same proportion as the part of consideration being paid by issue of shares bears to the total consideration; the amount of consideration for acquisition of the asset or settlement of liability to be paid in the form of shares, to the extent credited to the share capital and share premium account by the company B = No. of shares issued by the company as part of consideration
8.	Shares issued or allotted on succession or conversion, as the case may be, of a firm into the company or succession of sole proprietary concern by the company	Amount received by the company for issue of shares shall be determined as under: ***Amount received = (A-B)/ C*** Where A = Book Value of the assets in the balance sheet less amount of tax paid as withholding tax/ TCS/ Advance tax payment as reduced by tax refunds and amount shown in the balance-sheet as asset, including the unamortised amount of deferred expenditure which does not represent the value of any asset (revaluation reserve, if any needs to be ignored). B = BV of liabilities shown in the balance sheet excluding: capital, by whatever name called, of the proprietor or partners of the firm; reserves & surpluses, by whatever name called, including balance in P&L account; provision for taxation (other than amount of tax paid as withholding tax/ TCS/ Advance tax payment, as reduced by tax refunds if any, to the extent of the excess over the tax payable with reference to the book profits, in accordance with the law applicable thereto); amount representing provisions made for meeting liabilities, other than ascertained liabilities; and amount representing contingent liabilities. C = No. of shares issued on conversion/ succession.

Sr. No.	Situation	Amount received by the company
9.	Shares are issued or allotted without any consideration on the basis of existing shareholding	Nil
10.	Shares issued pursuant to conversion of preference shares or bond or debenture, debenture-stock or deposit certificate in any form or warrants or any other security issued by the company	The amount received in respect of such instrument so converted.
11.	Shares held in dematerialised form	The amount received by the company, determined in accordance with this rule on the basis of first-in-first-out method.
12.	In any other case	Face value of the shares

Editor's note

The much-awaited final rules in relation to determination of amount received by the company on issue of shares, being subject matter of tax on buy-back have now been notified by the CBDT. The rules provide clarity on some more situations of issue of shares as compared to the draft rules. However, practical issues in implementation of the rules may need further guidance. As the rule is applicable from 01 June, 2016, the taxability of buy-back of shares executed between 01 June, 2016 up to the date of notification could be a challenge.

Companies Act

Notification of structuring and winding up related provisions under the Companies Act, 2013

The Ministry of Corporate Affairs (MCA) notified the much awaited sections in the Companies Act, 2013 (CA 2013) dealing with amalgamation, compromise, arrangement, acquisition, liquidation and winding up, to be effective from 15 December, 2016. These new provisions are likely to bring a paradigm shift in the manner in which these structuring processes are carried out. One of the key changes is that the NCLT will replace jurisdiction of HC as the sanctioning/ monitoring authority in relation to structuring and other company law matters. The NCLT has been set up as a specialised body to deal with Company Law matters. Absence of clearly laid transitional provisions may lead to some confusion in initial/ pending matters; however, in the long run, this change is expected to result in smoother processes and reduction in time frame for the same.

Arrangement

Provisions relating to Compromise or Arrangement between a company and its members/ creditors are contained in sections 230 and 231 of the CA 2013, which are nearly on similar lines as the existing provisions contained in section 391 of the Companies Act, 1956 (CA 1956). Basic process requirement continues to be:

- Application to the NCLT for direction to call for and hold meetings of shareholders/ creditors, for approving the Scheme of Arrangement (the Scheme)
- Holding meetings as per the direction of the NCLT and obtaining approval, of 50 percent in numbers and 75 percent in value, of shareholders/ creditors

- Obtaining and considering objections/ suggestions from sectoral regulators and other authorities
- Making petition to the NCLT for sanctioning the Scheme
- Final hearing on the petition and obtaining order of the NCLT approving/ rejecting the Scheme

Though the basic framework continues to be the same, following are a few major changes in the process under CA 2013 as compared to the erstwhile process under CA 1956:

- Disclosures in, and attachment to, notice calling meeting have been substantially increased
- The new process provides for issue of notice to all concerned statutory and other authorities simultaneously, with issue of notice to shareholders/ creditors. The concerned authorities are required to respond with their suggestions/ objections within 30 days, failing which they are deemed to have no suggestion/ objection. Earlier, this notice was required to be given to the regional director, income-tax authorities and official liquidator after the petition was filed with the HC. Thus, all necessary approvals/ objections will be in place before the petition is filed with the NCLT for final approval.
- The new process provides that the NCLT can dispense with the creditors' meeting only if 90 percent of the creditors give their consent to the Scheme by way of affidavit. Earlier, the HC had unrestricted power to decide on dispensation with the requirement to hold a meeting.
- Auditor's certificate to the effect that the accounting treatment specified in the Scheme is in conformity with the prescribed Accounting Standards is required to be submitted to the NCLT. Earlier, such certificate was required to be submitted only in case of listed companies under the SEBI regulations, but there was no requirement under CA 1956.
- The new provisions allow voting at the meeting as well as through postal ballot/ electronic mode.
- The new provisions prescribe that shareholders holding at least 10% of shares, or creditors having at least 5 percent of the total outstanding debt only can raise objections to the Scheme. Earlier, no such limit was prescribed, which allowed a holder of even a small number of shares/ quantum of debt to object to Scheme on trivial matters and delay the process. This should reduce unnecessary litigation created by small stakeholders.
- Sanction of buy-back, variation of rights, etc. being part of the Scheme, can be sanctioned only if they are in accordance with the provisions governing such processes. Earlier provision allowed the court to approve all matters included in the Scheme, notwithstanding other provisions of the CA 1956.
- New provisions enable provision of exit opportunity to shareholders of listed transferor company merging with an unlisted company.
- New provisions also enable making a takeover offer in a Scheme; however, those provisions have not yet been notified.

Amalgamation/ Demerger

Provisions relating to Amalgamation/ Demerger are contained in sections 232 of the CA 2013, and are in line with the existing provisions contained in section 394 of the CA 1956. Basically it provides for the NCLT to pass orders relating to and enabling transfer of assets/ undertaking of the transferor company, in addition to matters already dealt with under sections 230-231.

Following are a few major changes in the process under CA 2013 as compared to the erstwhile process under CA 1956:

- Under the existing provisions, amalgamation of certain non-company entities with a company is possible. However, in absence of similar provisions in CA 2013, amalgamations of non-company entities with a company may not be possible.
- Report adopted by the board of directors explaining the impact of the Scheme and valuation report on promoters, non-promoters' shareholdings, key managerial persons, etc., and difficulties in valuation, etc., is required to be disclosed in the notice of meeting of shareholders.

- Scheme of Amalgamation/ Demerger needs to clearly indicate Appointed Date. The NCLT is allowed to change the Appointed Date to an earlier date after recording its reasons in writing.
- Shares of the transferee company are not allowed to be held in the name of the transferee-company or under a trust for the benefit of the transferee company or its subsidiary, or an associate company, but such shares are required to be cancelled or extinguished. This means that creation of treasury stocks is not allowed under CA 2013.

Fast Track Amalgamation

CA 2013 has introduced section 233, enabling amalgamation of certain specified companies on a fast track basis, without intervention of the NCLT. These provisions are applicable to amalgamation of small companies, or amalgamation amongst a holding company and its wholly owned subsidiaries. 'Small company' is defined to mean a company having less than INR5 million paid-up capital, and having annual turnover of less than INR20 million.

Basic process involved is as follows:

- Companies involved to call for meeting of shareholders/ creditors for approving the Scheme.
- Companies to issue notice to ROC/ Official Liquidator (OL) inviting objections/ suggestions to be received within 30 days thereof.
- Objections received from ROC/ OL to be considered in the shareholders' meeting.
- The Scheme has to be approved by members/ classes of members holding 90% of the total number of shares
- Scheme to be approved by creditors or classes of creditors holding 90% in value, either at a meeting held or otherwise approved in writing
- Each company should file a declaration of solvency with the ROC
- The Transferee company should file the approved Scheme with the Central Government (CG), ROC and OL
- ROC/ OL shall communicate their objections within 30 days
- If in the opinion of the CG, the Scheme is not in the public interest, or in the interests of the creditors, CG may file an application with the NCLT within 60 days of the receipt of the Scheme, requesting the NCLT to consider the Scheme under the provisions of section 232 discussed above.
- Unless the CG forms an opinion as above, the CG shall register the Scheme and issue confirmation to the companies.
- On receipt of an application from the CG or another person, the NCLT may confirm the Scheme or, if in its opinion it is necessary, direct that the procedures as per amalgamation provisions discussed above should be followed.

The principal benefits of the fast track merger over amalgamation are:

- Approval of the NCLT is not required
- Notice is not required to be given to various authorities
- Shorter timeline
- Auditor's certificate of compliance with applicable accounting standards is not required

This form of amalgamation will provide reduction in timelines, and a good deal of flexibility. However, the low possibility of the CG converting Fast Track merger into normal amalgamation process under section 232 may restrict its usage in initial period.

Minority buyout

CA 2013 has introduced section 236 dealing with buyout of minority shareholding under certain circumstances. This will provide greater flexibility to the promoters/ acquirer in realigning the control and management of the company, with removal of unnecessary interference from minority shareholders. At the same time, it will provide an exit opportunity to minority shareholders at an appropriate price.

The salient features of the new provisions are:

- Any person or group of persons holding 90 percent or more of the issued equity capital of a company can purchase the remaining equity shares of the company from minority shareholders at a price determined by a registered valuer in accordance with prescribed rules.

- The majority shareholders shall notify the company and make an offer to the minority shareholders.
- The majority shareholders need to deposit the value of shares to be acquired by them in a separate bank account. The disbursement of consideration has to be made to minority shareholders within sixty days.
- Majority shareholders include acquirer and persons acting in concert as defined under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997
- The minority shareholders of the company may also offer to sell their shares to majority shareholders.
- The transferor company to act as a transfer agent for receiving/ paying the price and to take/ give delivery of shares. It is provided that in case physical delivery of shares is not received, the shares should be deemed cancelled and new shares to be issued; and the transfer should be completed in favour of majority shareholders and payment made to minority shareholders.
- The new provision seem to be equally applicable to listed companies.

Reduction of capital

Section 66 of the CA 2013 deals with reduction of capital, and continues to define it inclusively. It covers mode of reduction of capital other than the three modes specifically enumerated in the section. Reduction of capital can be with payout or without payout.

Basic process for approval of reduction of capital more or less continues to the same. It involves passing of special resolution by shareholders and confirmation of the same by the NCLT, instead of by the HC under the erstwhile provisions.

The following are the key changes made under the new provisions:

- A company which has defaulted in the repayment of any deposits accepted by it or the interest payable thereon, is not allowed to undertake reduction of capital till the time such default is remedied.
- NCLT to give notice of application for Reduction of Capital to the CG, ROC, SEBI (in case of listed companies) and to the creditors of the company.
  - CG and others may make representations within three months from date of receipt of the notice, and if no representation is received within the said period, it will be presumed that they have no objection to the reduction of capital. Under the existing provisions, no such notice was required.
  - Under the existing provisions, notice to creditors was required only in cases involving reduction in liability in respect of unpaid shares, or reduction involving payment to shareholders. In other cases, the HC had the discretion to direct issue of such notice. Under the new provisions, notice to the creditors is made mandatory in all cases.
  - This process, besides other impacts, may increase overall time frame of the process.
- The company needs to file a certificate from its auditor to the effect that the accounting treatment for reduction is in conformity with the prescribed accounting standards.
- It has been clarified that the provisions relating to reduction of capital should not be applicable to Scheme of Compromise/ Arrangement involving reduction of capital and to buy-back of shares.
- Under the existing provisions, minutes confirming reduction of capital were deemed to be amendment to Memorandum of Association (MOA). However, in absence of similar provision, separate process of amending MOA may be required to be followed.

Variation of shareholders' rights

Section 48 of CA 2013 is almost similar to provisions of sections 106-107 of CA 1956, and provides for variation of rights of shareholders in case of a company having more than one class of shares. The new provision has one material change as compared to the existing provision. It is now provided that in case the variation of rights of one class of shareholder impacts rights of any other class of shareholders, approval of the other class of shareholders will also be required to be obtained.

Winding-up

- Sections 278 to 303, section 324 and sections 326 to 365, dealing with winding up of companies through the NCLT have been notified. The process is almost similar to the corresponding provisions under CA 1956.
- Sections 370 to 378, dealing with unregistered companies, i.e., partnership firms, etc., and their winding up are notified. The new provisions are almost on the same lines as corresponding provisions under CA 1956.
- Section 391(2), which clarifies that the provisions relating to winding up shall equally apply to closure of the place of business of foreign company in India as if it were an Indian company, has also been notified.

Other notified sections

- Section 235 of the CA 2013 dealing acquisition of shares, and section 237 dealing with power of CG to amalgamate certain companies in the national interest have also been notified. Both the new sections are almost the same as the existing corresponding sections under CA 1956.
- Other connected provisions like definitions of certain terms, etc. have also been notified.
- Section 434(1)(c), providing for transitional provisions relating to newly notified sections, has also been notified. It provides that all proceedings relating to arbitration, compromise, arrangements and reconstruction which are pending before the HC shall stand transferred to the NCLT, which may proceed to deal with such proceedings from the stage before their transfer. Thus, all Scheme matters pending before the HCs on 15 December 2016, at whatever stage they are, will be transferred from the HC to the NCLT, and will be completed by the NCLT. However, matters which are reserved for orders shall not be transferred. As regards winding up matters, it is provided that certain matters will be completed by the HC, and the remaining matters will be transferred to, and completed by, the NCLT

Editor's note

- With the notification of the aforesaid sections, the burden on HCs with respect to Company Law procedure has been almost entirely shifted to the NCLT.
- It is expected that this important change in law would bring in substantial efficiency in the manner in which amalgamation, compromise, arrangement, liquidation and winding up, etc. are carried out.
- As regards winding up matters, it is important to note that both, voluntary winding up and winding up proceedings relating to the company's inability to pay debts, are now covered under the provisions of the Bankruptcy and Insolvency Code, 2016 (the Code) and are deleted from CA 2013. Though the adjudicating authority continues to be the NCLT, the adjudication will be under the Code, and not under CA 2013. CA 2013 now has provisions only relating to winding up of solvent companies through the NCLT, and winding up of unregistered companies.
- Thus, with this new notification of sections and deletion of winding-up provisions, very few sections, including merger of foreign companies, remain to be notified under CA 2013.

MCA constitutes NCLT and NCLAT and notifies certain provisions of Companies Act, 2013 to make them operative

Notification Nos. S.O. 1935(E) & 1932(E)

The NCLT and the NCLAT have been constituted by Central Government with effect from 1 June, 2016. This would effectively dissolve the CLB as constituted under the Companies Act, 1956 from the same day.

The NCLT will start functioning with eleven Benches – two at New Delhi and one each at Ahmedabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata and Mumbai. The Principal Bench of the NCLT will be at New Delhi.

Some provisions of the Companies Act, 2013 (mainly pertaining to powers of the CLB) relating to powers of Tribunal have also been notified by the Government (that were not effective due to non-constitution of NCLT) except provisions pertaining to compromise and arrangement, winding up etc.

The MCA has, *vide* notifications dated 01 June, 2016 notified the constitution of NCLT and NCLAT by the Central Government under the provisions of the Companies Act, 2013 (the 2013 Act). MCA has further notified certain provisions of the 2013 Act, thereby making the functioning of NCLT and NCLAT operative from 01 June, 2016. The table below summarises the key provisions of the 2013 Act notified by MCA to be operative from 01 June, 2016:

Clauses	Particulars	Remarks
Incorporation of Company	Power of NCLT to pass orders, where a company has been incorporated by furnishing any false information/ suppressing any material fact or information or by any fraudulent action.	• The power to remove the name of the company from the register of companies would still remain with the Registrar of Companies; • The power to orders for winding up of the company would still remain with the HCs.

Clauses	Particulars
Alteration of Articles	Alteration of Articles having the effect of conversion of a public company into a private company.
Issue & redemption of preference shares	Issue of fresh redeemable preference shares where the company is not in a position to redeem preference shares and to pay dividend.
Alteration of share capital	Consolidation and division of share capital results in changes in voting percentage of shareholders.
Further issue of share capital	Conversion of debentures issued or loan obtained from Government by a Company into shares – if terms of conversion are not acceptable to the Company, appeal can be filed before the Tribunal.
Debentures	Petition to be filed with the Tribunal on failure by the company to redeem the debentures or pay interest on them.
AGMs, meeting of members	Power of the Tribunal to call annual general meeting, meetings of members in specified cases.
Inspection of minutes book of general meeting	Power of Tribunal to grant inspection of the minutes book of a general meeting as requested by a member in a situation of refusal or default.
Re-opening of accounts and voluntary revisions of financial statements or Board's report	Re-opening of accounts to be done only on approval of Tribunal. Approval of the Tribunal required for voluntary revision of financial statements or Board's Report.
Removal, resignation of auditor and giving special notice	Powers granted to Tribunal to remove the auditor ***suo moto*** or on application made by the Central Government.
Removal of Directors	Powers of Tribunal in relation to removal of director.
Investigation into company's affairs in other cases	Powers of Tribunal to investigate into the company's affairs in specified cases.
Investigation of ownership of the company	Powers of Tribunal to investigate into the ownership of the company.
Protection of employees during investigation	Approval of Tribunal required for any action proposed against the employee protection of employees during Investigation.
Freezing of assets of company on inquiry and investigation	Tribunal to have powers for the said sections.
Imposition of restrictions upon securities	

Clauses	Particulars
Damages for fraud	Failure of the company to repay the deposit along with interest within the time limit (extension if any granted by the Tribunal as per section 74) or acceptance of deposit with an intention to defraud the depositors, or for any other fraudulent purposes. (See Note 1. below).
National Company Law Tribunal & Appellate Tribunal	Detailed provisions in relation to operation, functioning of the Tribunal and its members.
Compounding of Offences	Power of NCLT to compound offences. See Note 2. Below

Notes

1. The reference to Tribunal is arrived from section 74. However, section 74 has not been notified to include NCLT as the regulatory authority for granting extension in the time limit.
2. Offences where the fine exceeds INR0.5 million will be dealt by the NCLT and offences with fine below INR0.5 million will be dealt by the officer authorised by the Government or Regional Director.

Editor's note

While notifying these provisions, the MCA has not considered the Companies (Amendment) Bill 2016 (pending before the Parliamentary Standing Committee) that provides for amendments to the 2013 Act, including amendment to be made on the constitution of the NCLT and NCLAT in line with the judgement of the SC in the Madras Bar Association v. Union of India [2010] 11 SCC 1 (SC) case. The MCA may gradually notify provisions relating to powers of HC under the 2013 Act/ 1956 Act in respect of reduction of share capital, winding-up and compromise or arrangement (merger/ demerger) and these matters may get transferred to the NCLT later on.

It appears that provisions relating to reduction of share capital, winding-up and compromise or arrangement (merger/ demerger), etc., will remain under the jurisdiction of the HC till the time these provisions are made effective. Further, one will have to wait for rules to be notified.

Case law
- Advertising, marketing and promotion expenses
- Corporate guarantees
- Intra-group services
- Intangible
- Base erosion
- Berry ratio

Notifications and circulars
- Multilateral Competent Authority Agreement
- TP provisions
- APA

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Transfer Pricing

Case law

Advertising, marketing and promotion expenses

Delhi HC rules on marketing intangibles in case of licensed manufacturers

ITA No. 110/ 2014 and ITA No. 710/ 2015(Delhi)

There is no international transaction due to incurring of AMP expenses for licensed manufacturers.

Background

For several taxpayers in India, both licensed manufacturers as well as distributors, the Revenue authorities alleged incurring of "excess" AMP, thereby creating a marketing intangible for the AE. The AE was required to compensate the taxpayer for such alleged brand-building services, along with a mark-up. The "excess" was measured with respect to AMP spend of comparable companies (i.e., BLT). This rationale, applied by Revenue authorities, was largely upheld by the Special Bench (SB) in the case of *LG Electronics India Private Limited* v. *ACIT [2013] 29 taxmann.com 300 (Delhi-Tribunal) (SB)* (LG ruling), which was consequently applied to several interveners in that case who were parties to the proceedings before the SB, and was later followed in the cases of many other taxpayers.

Thereafter, appeals before the Delhi HC were filed by various affected taxpayers (most of whom were interveners before the SB) against the Division Bench rulings in their respective cases, wherein essentially, the ratio of the LG ruling was applied, regardless of their individual fact pattern.

Until the HC pronounced its decision, the anxiety of the affected taxpayers kept mounting. When the HC eventually gave its verdict in the case of Sony Ericsson Mobile Communications Private Limited & Others v. CIT [2015] 55 taxmann.com 240 (Delhi), there was immediate euphoria, as the decision laid down some principles in line with global guidance and upturned the LG ruling in many ways (including the use of the BLT). This HC ruling was in respect of taxpayers engaged in the distribution of branded products of their AEs (the ruling of Sony Ericsson Mobile Communications Private Limited & Others v. CIT [2015] 55 taxmann.com 240 (Delhi) hereinafter referred to as "distributor's ruling"). Although there were some important principles therein that could be applied to licensed manufacturers (and buy-sell entrepreneurs) as well, taxpayers engaged in licensed/ full risk manufacturing, however, have been awaiting a ruling on their set of facts.

Finally, the wait of taxpayers in the licensed manufacturing fraternity has ended, as the HC has pronounced the ruling, wherein it has held that AMP expenses incurred by the taxpayer could not be treated as an international transaction under section 92B of the Act (hereinafter referred as "manufacturer's ruling").

Held

The HC essentially adjudicated on the following questions of law:

Whether the additions suggested by the TPO on account of AMP expenses were beyond jurisdiction and bad in law, as no specific reference was made by the TO with regard to retrospective amendment to section 92CA of the Act by the Finance Act, 2012.

The HC agreed with the distributor's ruling in this regard and held that the TPO could have examined the question of whether AMP expenses constituted an international transaction, even in the absence of any specific reference being made on that behalf by the TO.

Whether AMP expenses incurred by the taxpayer in India could be treated and categorised as an international transaction under section 92B of the Act.

The HC held the following:

The distributor's ruling covered taxpayers who were themselves not manufacturers. Further, none of them appeared to have questioned the existence of an international transaction involving the concerned foreign AE. Hence, the Revenue's argument that the distributor's ruling affirmed the existence of an international transaction on account of the incurring of the AMP expenses in the context of licensed manufacturers as well, was rejected.

The Revenue applied the BLT to confirm the existence of an international transaction. However, once the BLT had been negated (in the distributor's ruling), there was no basis on which it could be said that there was an international transaction on account of AMP expenses incurred by the taxpayer.

It was *de hors* the BLT that the existence of an international transaction on account of AMP expenses had to be established.

The Revenue's argument that the payment of royalty to the foreign AE also meant that the foreign AE benefitted from the AMP expenses, was rejected, as it was not supported by empirical data, and proceeded more on the basis of surmises. The royalty was anyway separately subjected to TP assessment.

It was incumbent on the Revenue to show the existence of an "agreement," an "understanding," an "arrangement" or "action in concert" between the Indian taxpayer and the AE as regards AMP spend for brand promotion. The burden was on the Revenue to first show the existence of an international transaction, whereby the Indian taxpayer had been obliged to incur AMP of a certain level for its AE's brand promotion.

The *sine qua non* for commencing the TP exercise was to show the existence of an international transaction with a certain disclosed price. The TP adjustment under Chapter X of the Act envisaged the substitution of the price of such international transaction with the arm's length price (and not simply a "quantitative adjustment," i.e., AMP of taxpayer *less* AMP as per BLT). It could not be deduced that an international transaction existed because there was "excessive" AMP expenditure on account of applying the BLT. An assumed price could not form the reason for making a TP adjustment. Further, the HC held that the very existence of an international transaction could not be a matter of inference or surmise.

The Revenue's argument that an independent party with a short-term agreement with the MNC would not incur costs to obtain long-term benefits of brand and market development unless it was adequately remunerated for it, was rejected. This was because this argument of the Revenue proceeded purely on surmises and conjectures, and if accepted as such, would lead to sending the Revenue authorities themselves on a wild-goose chase of what could at best be described as a mirage. Additionally, there was no statutory mandate for such an exercise.

There was no machinery provision under Chapter X of the Act, which was similar to section 40A(2)(a) of the Act, wherein a Revenue officer carried out a "best judgement" assessment. In particular, section 92F(ii), which defined arm's length price, could not be considered to be a machinery provision enabling the determination of the existence of an international transaction. The strength of a brand could depend on several factors. Thus, a simplistic approach using one of the modes similar to the ones contemplated by section 92C of the Act, would not only be legally impermissible, but also lend itself to arbitrariness.

As neither substantive provisions nor machinery provisions of Chapter X of the Act were applicable to an AMP adjustment, the inevitable conclusion was that Chapter X as a whole did not permit such an adjustment.

Any incidental benefit to the AE on account of AMP expenses incurred by the taxpayer should not lead to an automatic inference of a service being rendered by the taxpayer to the AE. The HC referred to paragraph 7.13 of the OECD Guidelines in this regard.

Further, the HC also referred to the discussion in the distributor's ruling on OECD guidelines in paragraphs 6.36 to 6.39, and agreed that AMP adjustment could not be made in respect of a full-risk manufacturer.

The HC agreed with what was held in the distributor's ruling, *viz.*, that if the margin of the tested party was higher than that of the comparables, then, applying the TNMM, there could be no question of an adjustment on account of AMP.

Editor's note

The HC has re-emphasised that the Revenue should satisfy the burden of proof cast upon them conclusively before any TP adjustment is made. The issue around marketing intangibles is highly factual, depending upon the FAR by each taxpayer, for which a common dictum could not have been followed by the Revenue, which would apply to taxpayers across the board.

The HC's verdict has answered the long-standing question of whether the AMP expenses incurred by licensed manufactures/ buy-sell entrepreneurs could be considered as an international transaction, in favour of taxpayers.

The earlier distributor's ruling, and now the manufacturer's ruling, by the HC are delights for taxpayers. These verdicts have upheld the correct approach in line with the fundamentals of TP as prescribed in the Act, and rely upon international TP Guidelines, including the

OECD TP Guidelines. The two HC rulings on the issue of marketing intangibles have once again boosted confidence in the Indian judiciary as the guiding force for laying down the right principles on TP.

This manufacturer's ruling has upheld the position that there is no international transaction due to AMP expenses for licensed manufacturers. This is in line with the fundamentals of TP, international guidelines including the OCED TP Guidelines, and supplements the relevant legal principles arising of the distributor's ruling for licensed manufacturers etc. (Kindly refer to the takeaways section in our news alert dated 18 March, 2015 on the distributor's ruling.)

AMP adjustment in case of licensed manufacturer with large turnover and a fully operational manufacturing, marketing and distribution system in India struck down

ITA No. 7732/ Mum/ 2010, ITA No. 1210/ Mum/ 2014, ITA No. 1167/ Mum/ 2014, ITA No. 393/ Mum/ 2015 (Mumbai Tribunal)

AMP adjustment proposed by TPO on account of expenses incurred by taxpayer resulting in promotion of the AE's brand was held to have been wrongly invoked, as the AMP expense incurred did not result in an international transaction.

Facts

The taxpayer was primarily a licensed manufacturer engaged in food processing. The taxpayer had entered into a brand license agreement for the use of brands owned by its AE in lieu of a royalty payment. During the transfer pricing audit proceedings, the TPO alleged that there was an arrangement between the taxpayer and its AEs, by virtue of which the taxpayer incurred excessive AMP, and thereby promoted the brands owned by the AE.

The TPO proposed an adjustment by using PSM, wherein 35% of the group profit was attributed to the AMP function [Relying on a precedent Delhi Tribunal decision (ITA No. 1496 to 1501/ Del/ 2007)].

Alternatively, TPO applied the BLT to compute the non-routine AMP incurred by the taxpayer, and arrived at the value of adjustment after applying a 10% mark-up on the non-routine AMP.

The DRP held that PSM was not an appropriate method. However, it upheld the TPO's action of applying BLT with a mark-up of 9.8%. The taxpayer appealed to the Tribunal.

Held

The Tribunal ruled in the taxpayer's favour and held that the AMP incurred did not result in an international transaction and that the TPO had wrongly invoked the provisions of Chapter X of the Act. In holding so, the following rationale was followed by the Tribunal:

- Since there was no agreement between the taxpayer and the AE whereby the taxpayer was obliged to incur AMP of a certain level for the AE for the purpose of promoting the AE's brand, no international transaction could be presumed. Reliance in this regard was placed on the principles laid down by the Delhi HC in a recent decision (Delhi HC verdict) *[Please refer to our news alert dated 14 December, 2015 on this decision (ITA No. 110/ 2014 and ITA No. 710/ 2015)]*.
- The taxpayer paid royalty to the AEs, based on the license agreement between the taxpayer and the AEs on a principal-to-principal basis. Royalty payment was one of the criteria to hold that the taxpayer was an independent unit.
- The TPO had not brought on record any evidence to prove that the taxpayer had rendered any AMP-related services to its AE. On the contrary, payments on account of AMP were made to unrelated domestic third parties.
- The taxpayer had a fully operational manufacturing, marketing and distribution system in India. The taxpayer's manufacturing unit had a huge turnover, which proved that the taxpayer had done reasonably good business. Accordingly, AMP was incurred by the taxpayer to promote its own business interests, and it could not be said that the AMP incurred by the taxpayer was aimed to benefit the AE, and that it should be compensated for it. The TPO had also failed to prove that the intent of the taxpayer was to promote the AE's brands and not its own business.
- The resultant profit was offered for taxation in India. Therefore, transferring of profit from India, the basic ingredient to invoke TP provisions, remained unproved.

Editor's note

In the instant case, the Tribunal has echoed the Delhi HC's verdict, and has gone a step further in clarifying and clearly articulating some more positions around the AMP issue.

An important observation made by the Tribunal is that a royalty agreement entered on a principal-to-principal basis demonstrates the taxpayer's independence (an Indian licensed manufacturer in the instant case). Notably, this observation has been made by the Tribunal in the context that AMP incurred by the taxpayer was to promote its own business interests (since it is an independent business unit), and not the brands owned by the AE. This is an important observation, as revenue authorities have often used payment of royalty by an Indian licensed manufacturer as a pretext to argue either that there is no need for AMP spend, or that there is a need for compensating the AMP spend.

Another noteworthy position laid down by the Tribunal in the instant case is that a mere allegation of the enhancement of the AE's brand value through AMP incurred by the taxpayer is not sufficient. The TPO ought to have demonstrated such enhancement before making an adjustment.

Furthermore, the Tribunal has acknowledged that AMP is incurred to promote the taxpayer's own business interests, and the fact that the profits earned by the taxpayer are subject to taxation in India implies that there is no base erosion. This is an important overriding principle which has been often ignored when dealing with the AMP issue.

These positions, as enunciated by the Tribunal, support many contentions often put forth by taxpayers who have faced TP adjustments on account of AMP. This verdict, therefore, is undoubtedly a positive and welcome precedent.

Corporate guarantees

Tribunals rule favourably on the issue of corporate guarantees; primarily on legal arguments

ITA no. 2631/ Mumbai/ 2015

Background

While the TP of financial transactions has received considerable attention from the Indian tax authorities and adjustments are made to most cases involving outbound corporate guarantees, taxpayers would find it heartening to see Indian Tribunals ruling favourably on this issue. Recently, there have been a series of rulings that have held that a corporate guarantee is not an international transaction under the provisions of section 92B of the Act, relying primarily on legal arguments.

The most recent rulings on the subject have been pronounced in the cases of the taxpayer and Siro Clinpharm Private Limited *v.* DCIT (ITA No. 2618/ Mumbai/ 2014). These concur with, and largely base their decisions upon, views expressed in two earlier pronouncements on corporate guarantees, i.e., Micro Ink Limited *v.* ACIT (ITA no. 2873/ Ahm/ 10) and Bharti Airtel Limited *v.* ACIT (ITA no. 5816/ Del/ 2012).

These rulings have provided findings mainly on the various legal dimensions that need to be considered and interpreted while evaluating corporate guarantees under the Indian TP framework and have held the following:

- Provision of a corporate guarantee would not constitute an international transaction unless the same has a bearing on the profits, income, losses or assets of the taxpayer.
- Explanation to section 92B enlarges the scope of definition of 'international transaction', and accordingly cannot be said to be retrospective in effect.
- When the issuance of corporate guarantee is in the nature of quasi-capital or shareholder activity, it does not amount to a service.
- As long as an area is adequately covered by the work of Indian legislation, guidance of the OECD or other international fora is not decisive.

Facts

In the ensuing paragraphs, we will dwell upon the important observations made and conclusions reached by the Tribunals, while dealing with this issue. A common fact pattern in all the four cases discussed herein is that the AEs in whose favour the guarantees were given were wholly owned subsidiaries of the taxpayers, the guarantees were issued prior to the insertion of Explanation to section 92B, and no guarantee commission was recovered by the taxpayers.

Most of the discussions in the above-mentioned rulings centre around three fundamental issues, and accordingly, we have captured the Tribunals' observations under these baskets:

- Can provision of corporate guarantee be viewed as an international transaction under section 92B of the Act?
  - Even after the Finance Act 2012 inserted the Explanation to section 92B of the Act, provision of a corporate guarantee would still not constitute an 'international transaction' unless the same had a bearing on the profits, income, losses or assets of the taxpayer.
  - The Tribunals have concurred that there could be a number of situations in which an item may fall within the description set out in clause (c) of Explanation to section 92B [covering Capital Financing, including guarantees], while perhaps not constituting an international transaction, as the condition precedent with regard to "bearing on the profits, income, losses or assets" set out in the main section 92B (1) may not be fulfilled. The Tribunals have then gone on to describe instances where such situations could arise:

    i. No cost to enterprise issuing such guarantees

    ii. Taxpayer could not have realised money by giving such guarantee to someone else during the course of its normal business.

    iii. Possibility of default, being a hypothetical situation, should not be considered; draws distinction between 'future' impact and 'contingent' impact

    iv. Bank guarantees have entirely different characteristics, and accordingly, could not be compared with corporate guarantees

Further, in the rulings of both the taxpayer and Siro Clinpharm (*supra*), the Mumbai Tribunal has opined that there was a subtle difference in '***impact on***' and '***influence on***'. The corporate guarantee may have an influence on the profits, income, losses or assets of the beneficiary entity (in whose favour such guarantee was issued), but it has no impact on the same as long as it was issued without consideration. It is important to mention here that while analysing corporate guarantees, several aspects would need to be considered, such as the nature of guarantee provided (financial or performance?), and whether it resulted in lowering borrowing cost of the beneficiary (which in turn would have an impact on its profits).

  - Interestingly, while considering the issue of impact on profits, the Tribunals have drawn a distinction from cases where the taxpayers themselves had charged guarantee commission [such as Everest Kanto v. ACIT (ITA no. 7073/ Mum/ 2012)] and Advanta India v. ACIT (ITA no. 1643/ Ban/ 2012), in which case the guarantees clearly had an impact on the profits of the taxpayers. Accordingly, the issue of whether the same constituted an international transaction would not have arisen/ come up for adjudication.
  - In Micro Ink Limited (*supra*), the Tribunal differentiated and dismissed the Revenue's reliance on the landmark Canadian ruling of GE Capital Canada v. Her Majesty the Queen [2009] TCC 563; on the following premises:

    i. it did not even deal with the fundamental question as to whether the issuance of corporate guarantee was an international transaction; and

    ii. provisions of Indian Income-tax Act and Canadian Income-tax Act were radically different

- Can Explanation to section 92B be applied retrospectively?

  In the Micro Ink (*supra*) and Bharti Airtel (*supra*) rulings, although the Tribunals did not conclude on the issue of retrospective application of Explanation to section 92B of the Act, they made certain observations on the matter:

  - Explanation to section 92B did indeed enlarge the scope of definition of "international transaction," even though it was described as being clarificatory in nature.

- The scope of a charging section could be enlarged with retrospective effect, but an anti-avoidance measure such as TP, which mainly sought compliant behaviour vis-à-vis certain norms, could not be given effect from an earlier date.
- The law did not compel a man to do what he could not possibly perform (drawing reference from the case of Krishnaswamy S Pd & Anr. v. Union of India & Ors. [2006] 281 ITR 305 (SC)).
- Further, a recent decision of the Delhi HC in the case of New Skies Satellite BV v. DIT [TS-64-2016-Delhi High Court], also comments on the applicability of clarifactory amendments. It observes that if an amendment is one that expands the scope of the section that it seeks to clarify, and as a result introduces new principles, then it is incapable of being given retrospective effect.
- Taking a cue from the observations of the Delhi HC, the Mumbai Tribunal in the case of Siro Clinpharm (supra), has stated that Explanation to section 92B has to be treated as being effective from AY 2013-14.

- Under what circumstances would a corporate guarantee be viewed as shareholder activity?
  - In Micro Ink (supra), the Tribunal draws references to the OECD Guidelines, an Australian discussion paper on guarantees and other international jurisprudence, to support the concept of 'shareholder activities' in the context of corporate guarantees. On a conceptual note, it recognises that where a guarantee compensates for the inadequacy of shareholder funding, it could be viewed as a mode of ownership contribution. However, in the end, it concludes that as long as an area was adequately covered by the work of Indian legislation, guidance of the OECD or other international fora was not decisive.
  - In the taxpayer's ruling, an additional aspect that the Tribunal has considered was the tripartite 'support agreement' between the taxpayer, its AE and the Banker (lender) and the obligations it cast on the taxpayer. The agreement required the taxpayer to make deficiency payments to ensure specified levels of net worth and coverage ratios.

    By recognising such arrangement as being in the nature of shareholder activity, the Tribunal has in a sense concurred with the global thinking on the subject, i.e., if a subsidiary could not borrow money from third-party sources on its own standing, and the guarantee provided by the parent enables it to make such borrowing, then the guarantee could be said to be a shareholder function, not warranting a guarantee fee.

Editor's note

The rulings discussed above have largely decided the cases focusing on legal interpretations around whether the provision of guarantee constitutes an international transaction, questioning the retrospective application of Explanation to sec 92B, and emphasising that Indian TP legislation would prevail. They have also discussed the principles around shareholder functions and the role of a corporate guarantee in circumstances such as the borrower's inability to raise funds on a standalone basis on account of financial or regulatory considerations. This is also the guidance that emerges from international rulings while evaluating the economic treatment of corporate guarantees from a transfer pricing standpoint, particularly on aspects such as shareholder functions, implicit v. explicit support, and benefit test through interest saving.

International guidance is meaningful to appropriately consider in terms of conceptual bearing in an evolving area such as corporate guarantees. Accordingly, taxpayers should continue to evaluate each case in light of individual facts and circumstances, while applying guidance around these dimensions and deciding the approach to corporate guarantees.

In this backdrop, the need to have robust, well-conceptualised TP policies and comprehensive analysis towards intra-group guarantee arrangements, and substantiating them through documentary evidence, conduct and commercial reasoning, cannot be over emphasised.

Tribunal acknowledges need to conduct credit rating and comparables search in a scientific and logical manner; deletes TP addition on guarantee being in nature of a shareholder activity based on facts

Tega Industries *v.* DCIT [ITA No. 1912/ Kol/ 2012(Kolkata-Tribunal)]

The Tribunal, restoring the matter to the TPO/ TO to determine the ALP of loan transactions, expressed the following:

- *For benchmarking the interest rate on a loan transaction, either an internal or external CUP can be applied, disregarding the lender's cost of funds.*
- *Estimation of credit rating of the borrower and identification of comparable transactions needs to be done, applying a scientific and logical methodology.*

In addition, the Tribunal upheld the taxpayer's contention that guarantee provided for a loan borrowed by its AE is in the nature of a shareholder activity, keeping in perspective the specific facts of the case.

Facts

Inter-company loan transaction:

The taxpayer, an Indian company, had set up a SPV in the Bahamas and granted a loan to the SPV for acquisition purposes. Further, it had also provided interest-free loans to its AEs in Australia and the United States of America (U.S.A.). On the basis of a benchmarking study (using borrowing data from different websites), the taxpayer determined LIBOR *plus* 100 basis points (bps) as the arm's length interest rate for all the loans granted to its AEs, and *suo moto* offered the notional income on it to tax.

Disregarding the taxpayer's benchmarking, the TPO computed the arm's length interest rate on the loans advanced to be 15.75% (for the Bahamas SPV) and 13.47% (for the AEs in Australia and the U.S.A.). For this purpose, the TPO used data from the Loan Connector database (LPC) to identify one comparable for the loan provided to Bahamas SPV, and one for comparison with the loans given to AEs in the U.S.A. and Australia. For identifying such comparable transactions, the TPO estimated the credit rating of the borrowing entities, using Standard & Poor Corporate Rating Criteria ("S&P criteria").

Additionally, for computing the arm's length interest rate, the TPO replaced LIBOR as the base rate, with the cost of funds of the lender.

Aggrieved, the taxpayer moved an application before the DRP. The DRP upheld the TPO's order, agreeing with his reasoning.

The taxpayer, thereafter, filed an appeal before the Tribunal.

Guarantee transaction:

The taxpayer extended a corporate guarantee to a bank towards a borrowing by the Bahamas SPV for undertaking an acquisition of companies. This was classified to be in the nature of shareholder service, warranting no charge.

The TPO held that a service has been provided by the taxpayer and even otherwise, any transaction that has a bearing on the profit or loss of the entities is covered under section 92B. Accordingly, the TPO made a transfer pricing adjustment with a charge of 2.5% as guarantee fee.

The TPO used the internationally recognised interest saved approach for arriving at the guarantee fee, giving reference to the Canadian Ruling in the case of The Queen *v.* General Electric Capital Canada Inc., 2011 DTC 5011 [at 5558], 2010 FCA 344. The credit rating and comparable used by the TPO while analysing the inter-company loan, was also used to arrive at the charge for the guarantee provided. While doing so, the TPO also concluded that the bargaining power of the AE *vis-à-vis* the taxpayer was minimal, thereby justifying a higher split of the interest saved, as guarantee fees.

The DRP confirmed the TPO's adjustment, agreeing with his reasoning.

Held

Inter-company loan transaction:

- The Tribunal recognised the principle of commercial expediency in relation to the loan advanced to Bahamas SPV, i.e., without injecting the funds, it was not possible for the subsidiary company to run the business for the benefit of the holding company.
- In order to benchmark a transaction under the CUP method, prices charged by parties in the open market would need to be considered, and the cost incurred was not relevant.

- The assessment of creditworthiness of the borrower is relevant and the same needs to be undertaken using a scientific and logical approach. Considering the additional evidence that the taxpayer furnished with regard to the credit rating and selection of comparables for the transactions with AEs in the U.S.A. and Australia, the Tribunal restored the matter to the file of the TPO/ TO for fresh examination with directions to ascertain the ALP.

Guarantee transaction:

The Tribunal concurred with the taxpayer's proposition, that the corporate guarantee provided were in the nature of a shareholder activity, and deleted the addition made by the TPO, keeping in perspective the following facts:

- Taxpayer's expectation from providing such guarantee was not to earn guarantee fees. Rather, the expectation was of a shareholder – to protect its investment interest.
- Guarantee was provided to help achieve the acquisition of the companies abroad, i.e., for furtherance of the taxpayer's own business, which would lead to returns in terms of appreciation in value and dividends.
- No third party would have agreed to grant loan of such quantum on an independent basis, given the AE's skewed debt/ equity ratio.

Editor's note

While Indian Tribunals have had several occasions to render decisions in the context of loans and guarantees, no defined positions have yet emerged around aspects such as credit rating estimation, notching principles, and economic adjustments. As evidenced in this case, one can expect increased sophistication and recognition of international guidance and jurisprudence, in the approaches adopted by tax authorities while evaluating financial transactions, clearly suggesting that ad hoc *approaches are unlikely to remain sustainable.*

Given the above, it is increasingly important for taxpayers to support their financial transactions with a comprehensive arm's length analysis. Towards this, a few noteworthy aspects are listed below:

- *Applying the selected TP method in an appropriate manner: In this ruling, the Tribunal has acknowledged that in order to benchmark a transaction under the CUP method, cost incurred was not a relevant consideration.*
- *Using scientific techniques for estimating borrower credit rating: As can be seen from the facts of this ruling, external credit rating agency guidance is subjective, and different rating agencies follow different approaches, thus leaving a lot to interpretation. Hence, it would be important for the taxpayer to make a careful selection, based on its specific facts and information availability.*
- *Undertaking methodical searches from available databases, considering specific debt characteristics such as tenor, type of loan (secured/ unsecured), etc.*
- *Making rational economic adjustments where necessary, to enhance comparability*

While the Tribunal's decision on the guarantee provided, being in the nature of a shareholder activity, is certainly a positive and welcome development, it needs to be borne in mind that such a contention would have to be based only on an evaluation of the specific facts of each case.

Intra-group services

Intra-group services to pass "need, evidence or rendition, and benefit" tests

ITA No. 5882/ Del/ 2010; ITA No. 5816/ Del/ 2011; ITA No. 6282/ Del/ 2012

In the context of intra-group services, guidance has been provided with respect to need test, evidence or rendition test, and benefit test similar to global best practices and OECD guidelines.

Facts

The taxpayer (ABC India), registered as a non-banking financial company, was engaged in the business of consumer financing in India. It provided loans for automobile purchase, consumer goods and personal loans. ABC India's international transactions during the FYs 2005-06, 2006-07 and 2007-08 (i.e. AYs 2006-07, 2007-08 and 2008-09 respectively) also included availing of consulting, administrative and IT services from its AEs. In order to establish arm's length nature of receipt of these services, ABC India selected foreign AEs as tested parties, applied TNMM as most appropriate method and selected

Operating Profit on Operating Costs (OP/OC) of foreign AEs as PLI. The taxpayer had benchmarked these services by using foreign comparables.

During the course of TP assessment proceedings, the TPO, based on the following observations, determined the arm's length price of these intra-group services at NIL.

- The taxpayer failed to provide documentary evidence to establish that services were actually required by it, and that these services were actually rendered to meet the specific requirements of the taxpayer;
- Services were incidental/ duplicative in nature, and could be categorised as shareholder and stewardship activities, and hence these services did not provide any economic and commercial benefit to the taxpayer.
- The taxpayer failed to satisfactorily explain the basis of allocation used for allocation of costs against these services;
- The AEs did not have infrastructure and manpower situated in India for rendering such services.

The TPO reached the conclusion that these services were not intra-group services and did not warrant arm's length remuneration. Accordingly, the issue of testing the arm's length nature of markup charged by the AEs did not arise.

The taxpayer objected to the TP additions before DRP, who confirmed the TPO's findings and upheld the TP additions. Thereafter, the taxpayer filed an appeal before the Tribunal. All three years' appeals involved common grounds on identical issues, and hence these three appeals were disposed off by the Tribunal by a common order.

The key arguments advanced by the taxpayer before the Tribunal are listed below:

- The DRP, in AY 2008-09, had accepted that services had been rendered by the AEs and received by the taxpayer. The DRP had considered 5% of the total cost allocated to the taxpayer as arm's length value of services, against the arm's length value at NIL as determined by the TPO. Therefore, the question whether the services were actually rendered and received did not survive;
- The services received from the AEs were very specific and specialised, which were not performed in-house, and hence these were not duplicative in nature;
- The benefit derived by the taxpayer could not be subject to the satisfaction of Revenue, as the Revenue could not dictate the business requirement/ commercial expediency of the taxpayer;
- The application of allocation keys was correct.

Held

The Tribunal had acknowledged the documentary evidence submitted by the taxpayer, and following the decision of HCs in the cases of Knorr-Bremse India P. Limited *v.* ACIT 2015-TII-51-HC-P&H-TP; Hive Communication P. Limited v. CIT [2011] 12 taxmann.com 287 (Delhi); and CIT v. Cushman Wakefield Limited [2014] 46 taxmann.com 317 (Delhi) dealt with the issue of need test, evidence or rendition test and benefit test in detail.

The key observations/ findings of Tribunal in the issue under consideration were the following:

- *Need test*: Looking at the size and continuous growth of the business of the taxpayer, and considering the information/ documents submitted and explanation provided, the need/ requirement of services was justified. The Revenue could not decide what was necessary for the taxpayer and what was not. The requirement of services should have been judged from the view point of the taxpayer as a businessman;
- *Evidence or rendition test*: The Tribunal acknowledged that the taxpayer had placed substantial material documents/ evidences to justify the receipt of services. The Tribunal had further stated that the taxpayer could only be asked to maintain and produce the evidence of receipt of service that a businessperson keeps and maintains regarding services received from a third party. The burden of maintenance of documents/ evidences could not be higher on the taxpayer merely because it was receiving services from its AEs.

- *Duplication test*: The TPO has not held that similar kind of services were already available with the taxpayer with any concrete evidence. In the absence of any instances of similar services provided by the AE, and from the fact that services availed by the taxpayer from the third parties were similar in nature, the TPO's viewpoint on the duplication test was not acceptable.
- *Shareholder service test*: Generally, shareholder services were those services that did not fulfil the need test, but were required for the purpose of maintaining and safeguarding the shareholders' interest. The shareholder services did not have any potential and foreseeable benefit likely to accrue to the service recipient. The services received by the taxpayer in the instant case were satisfying the need test, rendition test and also the benefit test, and therefore, these services could not be held to be shareholder services.
- *Cost-Benefit test*: As per section 92(2) of the Act, the arm's length price of transactions in the nature of cost or expenses allocation, or apportioned to an enterprise or contributed by an enterprise, shall be determined having regard to the arm's length price of such benefits, service and facility. This section also covers intra-group service transactions, as the charge for the services were often based on cost allocation/ apportionment. Therefore, the benefit test was a necessary part of determining the arm's length price of any intra-group services.

The 'benefit' needed to be identified from the taxpayer's viewpoint, which could be potential, reasonable, foreseeable, may not be quantifiable in money alone, and may be strategic, but could not be incidental. The benefit also could not have qualifications such as "substantial," "direct" and "tangible" because these qualifications were not given in section 92(2) of the Act. The Tribunal has clarified that mere profitability alone could not be the criterion for benefit. There were several non-monetary terms other than profitability, such as usefulness, enhancement in value, sustainability and enhancement of business interest, which were required to be seen while judging the benefit test.

Editor's note

The OECD TP Guidelines mention two main aspects to be considered while determining the arm's length price of intra-group services: (a) whether intra-group services have been rendered – the activity performed has provided the respective group member with economic or commercial value to enhance its commercial position; and (b) whether the amount of the charge, if any, is in accordance with the arm's length principle. This means that the charge for intra-group services should be that which would have been accepted between independent enterprises in comparable circumstances. This ruling would certainly provide guidance to taxpayers in establishing the need test, evidence or rendition test, and benefit test similar to global best practices and OECD guidelines.

"Benefit test" is necessary for determination of arm's length nature of intra-group services; however, it should not always be viewed in terms of profitability as there are numerous non-monetary factors that a businessman considers while doing business.

The Tribunal has relied upon jurisdictional HC ruling in the case of Cushman & Wakefield Limited (supra) to uphold the principle that the benefit test for determination of arm's length price has to be viewed from the perspective of the taxpayer, and not from revenue's perspective. However, this ruling does not comment on who (TO or TPO) has the statutory authority to apply the "benefit test." The ambiguity about who would apply the benefit test would remain a contentious issue.

Taxpayers are required to maintain detailed, robust and contemporaneous documents/ information to establish need test, evidence or rendition tests and benefit tests. It is also important to keep detailed workings to demonstrate any cost relating to shareholder activity(ies), and exclude the same before cost is allocated/ apportioned using reasonable allocation keys.

Intangible

Hard to value intangibles – TP perspectives from recent Tribunal ruling

DQ (International) Limited *v.* ACIT [ITA No. 151/ Hyd/ 2015 (Hyderabad-Tribunal)]

Tribunal rejected the TPO's proposition to replace projected cash flows used for valuation of IP with actuals available at the time of

assessment. The Tribunal also rejected the TPO's action of attributing a majority of the profits earned by the Irish AE to the taxpayer. The Tribunal held that there was no international transaction as per section 92B of the Act after sale of the IP by the taxpayer to its AE.

Facts

The taxpayer, an Indian company, was a leading producer of animation visual effects, game art and entertainment content for the Indian as well as global media and entertainment industry. During the year under consideration, the taxpayer sold under-developed IP rights of an animation series to its subsidiary in Ireland (ABC Ireland). The valuation for the IP rights was based on the average of two detailed independent valuations. The TPO made adjustments for the IP sale value and profit attribution from the exploitation of the IP. There were two other additions made by the TPO on management fees and recovery of expenses. These two adjustments are not discussed here.

The key contentions raised before the Tribunal were as follows:

Adjustment on sale of IP

Contentions of the TPO

- The TPO observed a wide difference between the projected cash flows (as per valuation) and the actual cash flows (as per financial statements of ABC Ireland)(actuals were higher than the projected numbers). The TPO also requested for clarifications.
- The TPO felt that since the difference between valuation and actuals was vast and fundamental, in uncontrolled circumstances, independent parties would have entered into a re-negotiation for the price or an adjustment to the negotiated price.
- The TPO replaced the projected figures with the actuals based on the financials of ABC Ireland, and determined the compensation based on actual numbers. The difference in compensation thus arising was identified as an adjustment.

Contentions of the taxpayer

- Valuation considering Discounted Cash Flow method or any other method is always applied considering the projected cash flows, which are based on the detailed market expectation as on the date of valuation.
- To factor the volatility of the global market and have normalised returns, the taxpayer had considered projections for 15 years.
- While the TPO replaced the projected cash flows with the actual numbers, the TPO erred in considering the total revenue generated by ABC Ireland. The total revenue generated by ABC Ireland was a result of different IPs, whereas cash flows projected by the taxpayer were only for the IP sold.
- The method adopted by the TPO of substituting actual values with projected values for determining the arm's length price was legally unsustainable and technically incorrect.
- The taxpayer relied on two judgments in this regard, *viz.*, Media India Ltd v. ACIT [ITA No. 1711/ Hyd/ 2012], which held that the valuation by independent valuers had to be accepted without modification; and Tally Solutions Pvt Ltd v. DCIT [ITA No. 1235/ Bang/ 2010] which rejected the approach adopted by the taxpayer of replacing projected cash flows with actual results (available at time of assessment) to revisit the IP value.

Adjustment of profit attribution

Contentions of the TPO

- The TPO concluded that the economic ownership of the IP lay with the taxpayer, and apportioned a majority (80%) of the residual profits earned by ABC Ireland to the taxpayer.
- The TPO relied on the following arguments in support of his proposition:
  - The legal ownership or bearing of costs alone was not sufficient to be entitled to all returns relating to the intangibles.
  - There were two circumstances when the transaction structure of taxpayer could be disregarded. *First*, where the economic substance differed from its form. *Second*, where the structure was

different from what would have been accepted by independent enterprises.

- Although India did not have wide ranging anti-avoidance rules under the domestic law, there have been various cases where Indian judicial authorities have highlighted substance over form.
- The transfer of assets, including intangibles, in connection with business restructuring could give rise to difficult valuation and other TP issues. Risk assessment should seek to identify such transactions and evaluate potential exposures.

- The TPO relied on the following facts to support his proposition:
  - During the year, there were no employees in ABC Ireland apart from two directors and one marketing manager. The financial statements of ABC Ireland also did not reflect any expenses towards rent or any owned building. The other expenses were minuscule.
  - The taxpayer had been in existence for over 10 years, had placed other IPs in the past, had key people (8 directors), and had its own presence and brand value. It, however, was trying to project itself as incapable compared to ABC Ireland, which was in its first year of operations.
  - It was improbable to imagine that such an established company as the taxpayer would sell at a relatively low price, IP which would be earning substantial revenue in the coming years.
  - ABC Ireland was a shell company located in a low-tax jurisdiction, being run by only two individuals. Therefore, the economic benefits could not lie there.

Contentions of the taxpayer

- There had been an outright sale of the IP from the taxpayer to ABC Ireland at a price, which was supported by independent valuers' reports. Hence, application of the PSM for revenues generated by ABC Ireland was legally unsustainable and factually incorrect.
- The TPO had taken the overall profits being generated by the ABC Ireland, which also included profits from various other projects. The profits not relating to the IP transferred had no connection with the taxpayer.
- The TPO had ignored the fact that the taxpayer had already paid tax on the capital gains arising from the transfer of the IP.
- It was not legally and factually tenable to attribute 80% of the profits of ABC Ireland to the taxpayer, when such profits solely belonged to ABC Ireland, which was the absolute owner of the intangible asset.

Held

Adjustment on sale of IP

- The Tribunal was in agreement with the ratio of the decision in Tally Solutions Private Limited (*supra*) that the projections made at the time of valuation could not be replaced with actuals. If the values were replaced subsequently, it was not valuation, but evaluation.
- The actuals could go either way; it could be beneficial either to the taxpayer or to the tax authority. Further, what was important was the value available at the time of making the decision, which should be left to the wisdom of the businessman, who knows what is good for the organisation.
- In the present case, the valuations were done by two independent valuers, and not by the taxpayer.

Adjustment of profit attribution

The international transaction ended when the TPO agreed that there was an outright sale. There was no international transaction that existed as per section 92B of the Act, as there was no transaction existing between the taxpayer and ABC Ireland. There is no doubt that tax planning was done, but there can be tax planning within the four corners of the tax laws. The TPO has not brought any cogent evidence to prove that there was any tax avoidance.

Editor's note

GAAR that bring along the fundamentals of 're-characterisation' and 'disregarding of actual transaction' will be effective in India from 01 April, 2017. Further, BEPS (Base Erosion and Profit Sharing) Action Plans 8-10 provide

guidance on intangibles, especially around hard-to-value intangibles, including circumstances in which tax authorities could disregard projections in favour of actuals, key non-routine functions around intangibles, and related areas. India is likely to take increasing recourse to this guidance in reviewing complex situations involving intangibles. It will be interesting to see how the judiciary's perspective on this evolves. Taxpayers should factor the above in developing their planning and defense strategy for intangibles.

Base erosion

Tribunal Special Bench rules on principle of 'base erosion'

Instrumentarium Corporation Limited, Finland *v.* ADIT [I.T.A. Nos. 1548 and 1549/ Kol/ 2009 (Kolkata-Tribunal)]

In the case of a non-resident taxpayer, a SB of the Tribunal ruled against the taxpayer, with respect to applicability of section 92(3) of the Act and on the issue of base erosion in that context.

Facts

The taxpayer, a non-resident engaged in the business of manufacturing and selling medical equipment, had a wholly owned subsidiary in India (the India Sub), which acted as the taxpayer's marketing arm for its products in India. The taxpayer advanced an interest-free loan to the India Sub. The TO held that an arm's length interest on this loan was required, and the same had to be taxed in the taxpayer's hands. The TO computed notional interest and brought to tax such an amount in the taxpayer's hands, which was upheld by the CIT(A). This was the crux of the dispute. Aggrieved, the taxpayer preferred an appeal before the Tribunal. A SB of the Tribunal was constituted to decide on the matter and answer the following question:

"Whether, on the facts and in the circumstances of the case, an ALP adjustment was required to be made in respect of interest-free loan granted by the taxpayer, a non-resident company, to its wholly owned subsidiary in India?"

Apart from the taxpayer (being the appellant), another entity also played the intervener before the SB. The key contentions put forth by the taxpayer and the intervener were quite similar, and have therefore not been segregated. They have been presented as "key contentions of the taxpayer." Similarly, the key contentions put forth by the Revenue in the intervener's case were quite similar to those put forth in the taxpayer's case, and have therefore not been segregated. They have been presented as "Key contentions of the Revenue." It should be noted that in the past, in relation to this transaction, the taxpayer had initially approached the AAR, which had declined to comment on the matter of determination of arm's length interest charge.

Key contentions of the taxpayer

- Computing an AL charge for the transaction would result in the erosion of the tax base, and consequent loss of tax revenue in India, which was not the intent of the Indian TP Regulations. Therefore, applying the provisions of section 92(3) of the Act, and CBDT circulars No. 12 and 14 of 2001, the TP provisions should not apply to the transaction in dispute. In support, reliance was placed on judicial precedents as per which CBDT circulars were binding on all field officers, and also on other judicial precedents as per which a statute should be interpreted to achieve and advance the legislative intent.
- Section 92(3) of the Act cannot be given such a restrictive meaning so as to examine the impact of taxability only in the taxpayer's hands, rather than of all its AE put together.
- Reliance was placed on "Taxation Ruling No. 2007/ 1" issued by the Australian Tax Office (ATO), as per which ALP adjustments were not required for interest-free loan advanced by a non-resident entity to a domestic company, even if it was making losses.
- An effort to increase losses (capable of being carried forward) had always been similarly viewed under the law as an effort to decrease profits. The expression 'income' always included 'losses. Thus, notional computation of tax should be taken into account for computing base erosion.
- The second proviso to section 92C(4) of the Act comes into play only when ALP is paid to the AE, as is evident from the

language of the proviso. This was not so in the instant case, as no payment was made by the India Sub.

- Other contentions: (i) grant of interest-free loan was in the nature of a shareholder service; (ii) commercial expediency of the interest-free loan could not be disregarded; (iii) interest-free loan being treated as interest-bearing amounted to re-characterisation, which was not permissible; and (iv) legally binding agreements between parties could not be disregarded.

Key contentions of the Revenue

- The 'base erosion' argument was unsustainable in law as the Indian Sub had been a loss-making company from the beginning, and thus payment of interest by it would only enhance the losses; the loss of revenue would be merely notional. In fact, the non-application of the AL principle would result in a real loss for the Indian Revenue, and not the other way round. Loss to the Revenue for the purposes of section 92(3) had to be real loss, and not hypothetical loss. Further, the time value of money could not be ignored, i.e., a rupee in tax, say five years from now, could not be treated as equivalent to a rupee in tax today.
- Section 92(3) of the Act comes into play only when the income of a taxpayer, in whose hands income from an international transaction is to be computed, stands reduced, or when the loss in his hands stands increased (and this was not so in the instant case).
- The taxpayer was earlier charging interest on loans given to the India Sub, but when the India Sub suffered losses, the taxpayer stopped charging the interest.
- The Indian AEs were not entitled to get any deductions in respect of adjustments made in the hands of the non-resident AEs. The second proviso to section 92C(4) of the Act had thus been misinterpreted.

Held

The SB rejected the 'base erosion' argument on account of the following:

Section 92(3)

- Section 92(3) of the Act essentially refers to the computation of income in the hands of the taxpayer in respect of whom income is being computed under section 92(1) of the Act.
- Section 92(3) does not contemplate taking a holistic view, considering lowering of overall profits/ increasing overall losses, i.e., not only for the taxpayer but in respect of all the AEs (taxable in India) taken as a whole.
- A plain reading of section 92(3) of the Act indicates that what is to be seen is impact on profits or losses for the year in consideration itself, rather than taking into account the impact on taxes for the subsequent years. The tax shield available to the Indian AEs as a result of accumulated losses, if any, could only affect income of the subsequent years, which were not relevant for the purpose of section 92(3) of the Act. Thus, if the transaction in the instant case was accepted without an ALP adjustment, then it would result in base erosion to the extent of taxability of interest in the hands of the non-resident taxpayer, as the India Sub had incurred a loss.
- To what extent this tax revenue could have been offset by the increase in the India Sub's loss was wholly academic, as there was no way to ascertain, at least at the assessment stage, as to whether this loss would be actually set off against future profits of the India Sub. The tax administration could not be expected to predict whether or not the India Sub would actually make sufficient profits in the next eight AYs to subsume the losses. Further, the time value of money could also not be ignored.
- Even if the plea that TP provisions were not to be invoked when overall profitability is reduced was accepted, it would have no impact on the present fact situation, as the benefit of loss was not real – it was contingent upon an uncertain event, i.e., profits being made in the future so as to subsume the losses. What was therefore known only with the benefit of hindsight today could not have been known at the time of assessment.

Second proviso to section 92C(4)

- If an ALP adjustment was made in the hands of a non-resident taxpayer (for example, a recipient of interest income), the Indian AE would not be entitled to get any additional deduction in respect of such an adjustment, as there was no provision in the law enabling such an additional deduction. Accordingly, there would be no base erosion.
- Further, this position did not change, irrespective of whether an altogether new income was brought to tax in the non-resident AE's hands, or there was an enhancement of income.
- The reference to the second proviso of section 92C(4) of the Act was thus unwarranted, as it applies to situations (Example: In a situation where, say, a resident taxpayer paid INR 100 as interest to its AE abroad, and duly deducted tax from the same, or the tax was deductible from the said payment, but the ALP of the interest was ascertained at INR 40. In such a situation, while deduction as per the AL principle had to be allowed only for INR 40, taxability in the hands of the AE would continue to be at INR 100) distinct from those prevailing in the instant case. This proviso constitutes a bar against the lowering of the non-resident AE's income as a result of lowering the deduction in the Indian AE's hands, rather than as enabling a higher deduction in the Indian AE's hands as a result of increasing the non-resident AE's income.

Reliance on Australian law

- The taxpayer's reliance on Australian law was rejected as, unlike the Australian law, the Indian TP regulations did not give any discretion to the tax administration for application of ALP when computing profits arising from international transactions.
- Further, in Australian law, as a result of ALP adjustments, consequential adjustments were permissible – no such adjustments were permissible in the Indian law.
- Since the relevant legal provisions were materially different, the clarifications issued by the ATO were not relevant.

CBDT circular

- CBDT's circular No. 14 of 2001 was not an 'order, instruction or direction' of the CBDT (as referred to in section 119 of the Act) that bound the field authorities.
- The role of 'intent of legislature' at best came into play only when there was ambiguity in the words of the statute sought to be interpreted (which was not so in the instant case).

In addition to the above, the SB also rejected the 'commercial expediency', 'shareholder service' and re-characterisation arguments of the taxpayer. Specifically, it held that commercial expediency of a loan to a subsidiary was wholly irrelevant in ascertaining the AL interest on a loan that is an international transaction between AEs. The loan would thus be covered by section 92 of the Act that mandated income from such transaction to be computed on the basis of ALP. Further, the question of re-characterisation arose only when the very nature of the transaction was altered, which was not so in the instant case, as the transaction under consideration continued to be a loan transaction. Finally, the SB directed the Division Bench to quantify the ALP adjustment.

Editor's note

Section 92(3) does not entirely embody the base erosion principle – CBDT circular 14 does

The principle of base erosion has been evaluated by the SB in the limited context of section 92(3) of the Act.

In cases with facts similar to those prevalent in the instant case, this provision (as also rightly held by the SB) will not be triggered in respect of the non-resident AE, because determination of AL interest will not result in reducing the AE's income chargeable to tax in India or increasing its loss [as is the requirement of section 92(3)] – on the contrary, it would increase its income chargeable to tax in India.

However, such AL interest determination will trigger the provisions of section 92(3) of the Act in respect of the Indian subsidiary. Accordingly, an ALP determination for a transaction could trigger section 92(3) for an Indian subsidiary while being inapplicable to the non-resident AE.

The applicability of section 92(3) of the Act would thus be restricted to only one of the parties to the transaction. Therefore,

section 92(3) of the Act, unlike CBDT circular No. 14 of 2001 (CBDT circular), does not embody the base erosion principle in entirety.

As per the CBDT circular, the underlying intent of the Indian TP Regulations is to "prevent shifting of profits outside India by manipulating prices charged or paid in international transactions," i.e., the intent is to prevent base erosion in India. The CBDT circular embodies the 'base erosion' principle, and is clearly and rightly so, qua India, and not qua any taxpayer, nor qua any AY.

Accordingly, the pricing of the loan transaction, from a base erosion standpoint, cannot be evaluated only with reference to section 92(3) of the Act (as has been done by the SB), but with reference to section 92(3) read with the CBDT circular.

'Base Erosion' principle should be applied qua India

In order to further the objective of preventing base erosion, the substantive section of the Indian TP code, i.e., section 92(1) of the Act, requires that any income arising from an international transaction shall be computed with regard to the ALP. Further, as per Rule 10D of the Rules, ALP is required to be contemporaneously determined by a taxpayer.

From a conjoint reading of CBDT circular No. 14 of 2001, section 92(1) and Rule 10D, contemporaneous determination of ALP would need to be undertaken by a taxpayer, and such determination cannot be bereft of the underlying intent of prevention of base erosion in India.

*Accordingly, if, at the price setting stage, an AL interest is determined for, say, an interest-free loan to be granted by a non-resident AE to its Indian subsidiary, and the AL interest is, say, INR 100, then the interest would be chargeable to tax in the hands of the non-resident AE, and would also be available for deduction in the hands of the Indian subsidiary (from, say, its total income of INR 1,000). If the Indian subsidiary is chargeable to tax at, say, 35%, while the non-resident AE is chargeable to tax at, say, 10% on gross basis, the AL interest determination would clearly result in revenue base erosion for India to the extent of INR 25 [-100*35% + 100*10% = -35 + 10 = -25].*

*If in the example above, the Indian subsidiary was making losses, the only difference will be that INR 100 will represent an increase in loss, to be carried forward and set off against future profits, rather than a decrease in profits. It is a well-accepted principle supported by various judicial precedents that there is a fundamental parity between increase in losses and decrease in profits in the context of computing income chargeable to tax (and this has not, in principle, been contested by the SB either). Further, carry-forward and set off of losses against future profits is a statutory entitlement. Having said that, since the intent of preventing base erosion is qua India, and not qua any AY (including any year in which there are losses), AL interest determination would thus again result in revenue base erosion for India to the extent of INR 25 [-100*35% + 100*10% = -35 + 10 = -25].*

ALP determination in the examples above would thus run contrary to the stated intent of the TP regulations, and would accordingly be unviable. The above aspects around the base erosion principle do not find mention in the SB ruling.

Concluding thoughts

The 'base erosion' principle is inherent and fundamental to the Indian TP regulations, and should be applied in a comprehensive manner.

Until such time that this matter is settled in a higher forum, the verdict of the SB will create more uncertainty rather than provide clarity in relation to similar transaction structures. Accordingly, going forward, taxpayers should resort to entering into APAs for 'both sides' of such transactions.

Berry ratio

Berry Ratio upheld by Delhi High Court

[2016] 71 taxmann.com 290 (Delhi)

- *"Berry Ratio" can be used as a PLI for stripped-risk distributors;*
- *Rule 10B(1)(e) of the Rules allows the use of Berry Ratio as a PLI;*
- *It is not permissible for the TPO to re-characterise the tested transaction; and*
- *Comparability factors enshrined in Rule 10C(2) have to be followed for determining the MAM.*

Facts

The taxpayer, an Indian subsidiary of a Japanese general trading company (*Sogo Shosha*), was engaged in: (i) provision of indenting services; and (ii) trading for resale in India. In the transfer pricing study, the

transaction of provision of indenting services was benchmarked by applying the TNMM as the MAM with Berry Ratio as the PLI.

The TPO applied the gross margin earned from non-AE trading transactions to the FOB value of goods and determined the arm's length commission for the indenting segment. The TPO observed that there was no difference in the FAR of the trading segment as compared to the commission segment. The TPO disregarded the volume of business in the respective segments on the ground that the taxpayer had entered into a separate contract with respect to each and every transaction/ trade.

The Tribunal agreed with the taxpayer's contention that the nature of the indenting transaction was different from the trading transactions, and observed that the indenting business of the taxpayer was purely of indenting nature, both in form and substance. Therefore, the Tribunal compared the commission earned by the taxpayer from the AE with the commission earned from non-AEs for the indenting transaction. In doing so, the Tribunal rejected the taxpayer's contention for allowing economic adjustment due to difference in volume in the AE segment *vis-à-vis* the non-AE segment.

The TPO had rejected the use of Berry Ratio as PLI on the following grounds:

- Use of Berry Ratio is not permissible under Rule 10B(1)(e);
- Berry Ratio is not an appropriate PLI where the taxpayer has acquired substantial intangibles in the form of supply chain and human resource intangibles;
- The rate of commission on indenting transaction was determined with reference to the value of goods, and not to the cost incurred.

Held

The HC ruled on these aspects as follows:

- The ALP has to be computed by using the MAM as referred in section 92C(1) read with Rule 10C(2). The Tribunal, in principle, had applied the CUP method. However, the mechanism adopted by the Tribunal was not correct;
- It disregarded the methodology adopted by the Tribunal in comparing the commission earned in the AE segment with that earned in the non-AE segment, on the ground that neither the Tribunal nor the TPO had conducted any inquiry to determine whether there was a significant variation in the rates of commission earned for different products in the respective segments, given the differences in volumes involved in the two segments;
- Use of Berry Ratio as a PLI is permissible under Rule 10B(1)(e)(i) because the rule mentions that the net profit realised can be computed having regard to "any other relevant base";
- The HC held that the Berry Ratio would apply where:
  - the value of goods dealt with by the taxpayer has no role to play in the profits earned, which are directly linked with the operating expenditure incurred by the taxpayer;
  - the operating expenditure incurred by the taxpayer captures the entire gamut of functions performed and the risks undertaken;

  Berry Ratio would not be an appropriate PLI where:
  - the taxpayer uses intangibles as a part of its business, since the value of such intangibles would not be captured in the operating cost;
  - the taxpayer utilises substantial fixed assets, since the value added by use of such assets would not be captured by the Berry Ratio;
- For the above reasons, Berry Ratio can be effectively applied only in cases of stripped-risk distributors, that is, distributors who have no financial exposure and risk in respect of the goods distributed by them.
- Application of Berry Ratio would provide unreliable results if the product mix of the taxpayer is different from the product mix of the comparables.
- The HC agreed with the TPO's observation that Berry Ratio cannot be applied where the taxpayer used intangibles. However, in the current case, the TPO could not produce any material to prove that the taxpayer had developed any supply chain or human resource intangibles.

Editor's note

This HC ruling lays down an important principle that the arm's length return has to be in pari materia *with the functions and risks undertaken by the taxpayer. Therefore, in the case of a stripped-risk distributor, the Berry Ratio could be an appropriate PLI to measure the arm's length return. However, in case of normal risk-taking distributors or entrepreneurial/ super distributors, Berry Ratio cannot be applied, since it will not capture the additional returns from undertaking enhanced functions.*

Comparability is an important factor while applying the Berry Ratio. Intensity of operating expenses of the comparables vis-à-vis *the tested party have to be carefully examined to avoid distortions to the Berry Ratio analysis. While ensuring that the intensity of operating expenses is comparable, functional and product comparability should ideally not be sacrificed. Additionally, there may be other limitations such as asset-intensive nature of comparables, expense classification in accounts, etc. Therefore, it is imperative to carefully select the comparables; and in certain cases, to also consider a corroborative analysis to supplement the Berry Ratio analysis.*

Berry Ratio has been accepted as a possible PLI in the OECD TP Guidelines and in the United Nations Practical Manual on TP for Developing Countries. Japan has also introduced the use of Berry Ratio in its tax legislation (from 01 April, 2013, the Berry Ratio was included in the Japanese TP legislation, by incorporation into the Order for Enforcement of the Act on Special Measures Concerning Taxation Articles 39-12 and 39-112). The Delhi HC has relied on the US Court case of E.I. du Pont de Nemours & Co. v. United States: 608 F.2d 445 (1979). In 1990, Berry Ratio was included as an acceptable PLI (under certain circumstances) under the Treasury Regulations of the U.S.A. Thus, with this Delhi HC ruling, the lower tax authorities in India may become more amenable to the use of the Berry Ratio in TP analysis.

The OECD TP Guidelines lay down guidelines for the applicability of Berry Ratio in the case of distributors. As per para 2.101 of the Guidelines, these are as follows:

- *The value of the functions performed in the controlled transaction (taking account of assets used and risks assumed) is proportional to the operating expenses;*
- *The value of the functions performed in the controlled transaction (taking account of assets used and risks assumed) is not materially affected by the value of the products distributed, i.e., it is not proportional to sales; and*
- *The taxpayer does not perform, in the controlled transactions, any other significant function (e.g., manufacturing function) that should be remunerated using another method or financial indicator.*

The Delhi HC has prescribed stringent conditions for the use of Berry Ratio, whereas the OECD Guidelines provide some flexibility for its application. For example, in practice, it is entirely conceivable that the tested party may have fixed assets; however, the use of Berry Ratio may still yield a more reliable measure of an arm's-length result as compared to any other PLI. TP is not an exact science, and consequently, decisions around the selection of the MAM and PLI are based on a relative comparison of the methods and PLI available. It would be prudent for taxpayers to thoroughly document their rationale for the use of the Berry Ratio, including the reasons for the non-applicability of other PLI, to mitigate the risk of the Berry Ratio being challenged by the Revenue authorities in TP audits.

Notifications and circulars

Multilateral Competent Authority Agreement

India signs Multilateral Competent Authority Agreement for automatic exchange of CbCRs

Multilateral Competent Authority Agreement

India's Finance Bill 2016 (the Bill) introduced the three-layered TP documentation requirements, pursuant to India's commitment to implementing Action 13 of OECD's BEPS project, on TP documentation and CbCR.

As per the Bill, CbCR is required to be filed by the ultimate parent entity of an international group or its nominated entity (that are resident in India), or in some circumstances, by a group entity that is resident in India, but whose parent is non-resident.

The filing is required to be done with a prescribed authority (yet to be prescribed). The prescribed authority in India would exchange CbCRs with designated authorities in other jurisdictions. To facilitate automatic exchange

of CbCR, India and five other countries, Canada, Iceland, Israel, New Zealand and the People's Republic of China, have signed the Multilateral Competent Authority Agreement on the exchange of Country-by-Country Reports (CbC MCAA), bringing the total number of signatories to 39 countries. The countries that had already signed the MCAA were Australia, Austria, Belgium, Chile, Costa Rica, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Malaysia, Mexico, the Netherlands, Nigeria, Norway, Poland, Portugal, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, the United Kingdom, Senegal, Bermuda, India, Canada, Iceland, Israel, New Zealand and the People's Republic of China.

This is a significant development towards the consistent implementation of Action 13 and cross-border co-operation on tax matters.

In detail

A model CbC MCAA has been provided in the BEPS Action 13 final report as an Annexure. In all likelihood, the 39 countries that have signed the CbC MCAA would have followed the model CbC MCAA. Apart from outlining the scope, safeguards and procedural aspects (including mechanics of exchange and timing), there are certain interesting features of the model CbC MCAA that are worth noting. These are as follows:

a) Before the first exchange of CbCRs, the CbC MCAA requires jurisdictions to have in place:-

   i. **safeguards** to ensure the confidentiality of information and use of information for high-level assessment of TP and other BEPS related risks;

   ii. **infrastructure** for effective exchange of CbCRs (i.e., timely, accurate and confidential information exchange, along with capabilities to resolve questions and concerns relating to the exchanges); and

   iii. **necessary legislation** that requires entities to file CbCR.

   Observation: *Since the CbC MCAA requires necessary legislation to be in place, it may be worth noting that even if any of the above-mentioned countries may have not yet enacted Action 13 (including CbCR) related legislation, the signing of the CbC MCAA indicates that these countries should soon have such legislation in place.*

b) The CbC MCAA categorically states that **TP adjustments** cannot be made simply on the basis of CbCR, as information in the CbCR on its own does not constitute conclusive evidence. Further, it provides that if at all such a TP adjustment is made, it would be conceded as 'inappropriate' in any Competent Authority proceeding (including MAP). The CbCR data, however, can be used for making further inquiries during the course of an audit.

   Observation: *How a Competent Authority will decide on the "inappropriateness" of an adjustment remains to be seen.*

c) The CbC MCAA provides for **consultations amongst the Competent Authorities** of the different jurisdictions in case of difficulties in implementation or interpretation of the CbC MCAA. Further, in case an adjustment to taxable income is made in an audit as a result of further inquiries based on the CbCR data, which leads to undesirable economic outcomes, the Competent Authorities will consult each other with the objective of finding a resolution.

   Observation: *Although the CbC MCAA does not define what constitutes an 'undesirable economic outcome', a possible 'undesirable economic outcome' could be double taxation. By providing for such consultation amongst Competent Authorities, the CbC MCAA seems to be enabling a mechanism similar to the MAP, although apparently more robust. In this regard, it may be worth mentioning that the model CbC MCAA nonetheless specifically states that MAP, on the basis of tax treaties, will continue to be applicable where CbCR has been exchanged on the basis of CbC MCAA.*

d) The CbC MCAA provides for **collaboration with respect to compliance and enforcement amongst the Competent Authorities** of different jurisdictions. As per the CbC MCAA, one Competent Authority will notify another if the former has reason to believe that an error may have led to incomplete or incorrect information reporting, or if there is non-compliance with respect to filing of CbCR.

Editor's note

Signing of the CbC MCAA by India is undoubtedly a significant development. Concurrently, the corresponding infrastructure, mechanisms, procedures and systems for cross-border information exchange may also need some strengthening/ streamlining, in order to ensure effective implementation.

Further, and more specifically speaking, considering that the CbC MCAA provides for resolution amongst Competent Authorities of 'undesirable economic outcomes', it may be interesting to see whether the signing of CbC MCAA by India, if at all, could help resolve the issue of absence of Article 9(2) in certain treaties. In the past, owning to the absence of this article in certain treaties (such as with Singapore, France, Germany, etc.), applications for MAP and bilateral advance pricing agreements have not been accepted by the Indian authorities, thereby leading to a deadlock in certain cases of double taxation. The signing of the CbC MCAA could be a possible solution to this matter, and if so, it would be a welcome relief for taxpayers.

TP provisions

CBDT issues revised and updated guidance for implementation of TP provisions

CBDT Instruction No. 3 of 2016 dated 10 March, 2016

Background

The CBDT has issued an Instruction for implementation of TP provisions. It is also effective from such date. To ensure procedural uniformity and to streamline the TP audit process, this instruction (the new instruction) provides guidance on reference by a TO to a TPO, the role of a TPO, and the role of a TO in case of TP audits. This new instruction replaces Instruction No. 3 dated 20 May, 2003 (the old instruction).

To provide some background information, almost five months before the new instruction was issued, an interim instruction (*Instruction No. 15 of 2015 dated 16 October, 2015*) had also been issued, after which taxpayers had put forth suggestions and posed queries. After considering such queries and suggestions, the CBDT has issued the new instruction to provide updated and adequate guidance that is applicable to both, international transactions and SDT.

In detail

The guidelines contained in the new instruction are either:

1. similar to the ones in the old instruction; or
2. have simply been updated based on the current relevant provisions of the Act and the Rules; or
3. are entirely new, i.e., did not exist in the old instruction or are a modified version of the old instruction, and are also not explicitly provided either in the Act or in the Rules as they stand as of today.

Here, we have focused on the third category of changes made in the new instruction [i.e., as stated in point no. 3 above]. These changes have been summarised below.

I. Selection of cases and reference by TO to TPO

At the outset, it is worth noting that as per the new instruction:

- for appropriate administration of the Act, the TO shall henceforth make a reference to the TPO only under the circumstances laid out in the new instruction;
- cases that may have been referred after issuance of the interim instruction, which are not in conformity with the new instruction, may be withdrawn; and
- the letter through which reference is made to the TPO must explicitly mention the transactions which are being referred, i.e., the international transaction(s) or SDT or both.

Situation 1: Cases selected on the basis of TP risk parameters

All cases selected for scrutiny on the basis of TP risk parameter(s) [either under the existing CASS system or under the compulsory manual selection system (CASS is selection on the basis of broad-based selection filters. The procedure and criteria for compulsory manual selection includes for example, cases involving addition in an earlier assessment year on the issue of transfer pricing in excess of INR100 million or more on a substantial and recurring question of law or fact that is either confirmed in appeal, or is pending before an appellate authority)]

have to mandatorily be referred to the TPO by the TO after obtaining necessary approvals from the respective senior officers. Certain guidelines in this regard have been provided:

- Where a case has been selected for scrutiny on a TP risk parameter pertaining to international transactions only, the international transaction(s) alone shall be referred to the TPO.
- Where a case has been selected for scrutiny on a TP risk parameter pertaining to SDT only, the SDT alone shall be referred to the TPO.
- Where a case has been selected for scrutiny on TP risk parameters pertaining to international transactions and SDT, the international transaction(s) and SDT shall together be referred to the TPO.

Since international transactions may be benchmarked together at the entity level due to inter-linkages amongst them, if a case has been selected for scrutiny on a TP risk parameter pertaining to one or more international transactions, all international transactions entered into by the taxpayer shall be referred to the TPO.

Observations on risk based selection of cases:

So far, selection of cases based on a monetary threshold has led to a significant number of cases being selected for TP audits. As a result, the focus had shifted from a qualitative investigation to a quantitative one.

Introduction of risk-based scrutiny is a very rational step taken by the Indian Government, which is in line with best practices followed globally, and will certainly streamline the TP audit process in India. With such an enormous dispute resolution burden, coupled with growing pendency of cases and already strained Revenue resources, risk-based selection of cases for TP audits was undoubtedly called for. Revenue authorities will now hopefully do justice to audits that are in fact 'worth it'. Further, valuable time of the judiciary will be effectively spent on 'meaningful' cases, and the Government will in fact be able to collect 'real' revenues.

Taxpayers can also now focus their energies on high-risk areas, and deploy their own risk assessment techniques in order to strengthen their documentation and defence files such that they are able to effectively manage compliance.

The introduction of risk-based selection of cases is also in line with one of the articulated purposes of CbCR that has been recently introduced in India vide *Budget 2016.*

However, the choice of risk parameters would determine how this policy change would be implemented on-ground, and whether or not it serves the stated purpose.

Observations on reference of international transactions which are benchmarked together at entity level:

Given that the reference would be for all the closely linked international transactions that have been benchmarked together, it would be worthwhile for taxpayers to consider benchmarking international transactions using a transaction-by-transaction approach wherever possible, to avoid unnecessary reference of transactions that are not considered risky even by the Revenue authorities.

Situation 2: Cases not selected on the basis of TP risk parameters

In respect of other cases, i.e., those that are not selected based on TP risk parameter(s), but also have international transactions or SDT, shall be referred to the TPO by the TO after obtaining necessary approvals from the respective senior officers, and only in the following circumstances:

- where the TO comes to know that international transaction(s) or SDT or both have been entered into, but either an Accountant's Report (AR) under section 92E of the Act has not been filed, or the transaction(s) has (have) not been disclosed in the AR;
- where there has been a TP adjustment of INR100 million or more in an earlier AY, and such adjustment has been upheld by the judicial authorities, or is pending in appeal (this is in line with the criteria for 'compulsory manual selection' for TP cases); or
- where search and seizure or survey operations have been carried out under the Act, and findings regarding TP issues have been recorded.

Observations:

Although these would be cases that are not selected based on specified TP risk

parameter(s), nonetheless, their reference has been deemed necessary by the CBDT as the abovementioned prima facie *represent circumstances that may need further evaluation from the Revenue's perspective.*

For Situations 1 & 2: Conditions and procedure for exercise of jurisdiction by TO for reference

Before making a reference to the TPO (as above), the TO must (as a jurisdictional requirement), in certain specified situations, record his satisfaction (after giving an opportunity of being heard to the taxpayer) that there is an income or a potential of an income arising and/ or being affected on the determination of ALP. These situations are as follows:

- where the taxpayer has not filed an AR, or has not declared one or more transactions in the AR, but the transaction(s) come(s) to the TO's notice, or
- where the taxpayer has declared the transaction(s) in its AR, but has made certain qualifying remarks to the effect that the said transaction(s) is (are) not international transactions or SDT, or that they do not impact the taxpayer's income.

If no objection is raised by the taxpayer to the applicability of Chapter X (sections 92 to 92F) of the Act to the above situations, the TO should proceed to make a reference to the TPO. On the other hand, if any objection is raised by the taxpayer, the TO must consider the same and pass a speaking order in respect of its decision to make a reference.

Observations:

The CBDT has acknowledged that Chapter X of the Act would apply only where an international transaction impacts, or has the potential to impact, income. This is undoubtedly a rational and legally appropriate approach, which will serve as a reminder for tax authorities that TP is not beyond fundamentals of taxation. On an overall basis, this approach also ties in with the underlying intent of the Indian TP regulations, i.e., that of avoiding 'erosion of tax base' in India. Further, this is also in line with the HC decision in the case of Vodafone (pronounced in October 2014 [Vodafone India Services Private Limited v. UoI [2014] 50 taxmann.com 300 (Bombay)]) wherein the HC had held that if an international transaction did not give rise to income under the Act, no occasion to apply Chapter X of the Act could arise in such a case.

The fact that the TO has to record his satisfaction after providing an opportunity of being heard to the taxpayer, would provide the taxpayer with an additional opportunity to present its position, and may prevent occurrence of unwarranted litigation, provided TOs are given sufficient guidance to implement this, as such issues have, in the past, been highly debated at higher judicial fora. Notably, this is the first time that such a window has been provided to the taxpayer at the stage of reference itself.

Since the TO is required to record his satisfaction where a taxpayer has declared an international transaction in the AR with qualifying remarks, in scenarios where the taxpayer contends non-applicability of Chapter X, it may be advisable to provide a note in the AR stating the taxpayer's position on such transactions. However, to make this workable, the online AR format would need to be modified to provide for notes.

Onus on the TO to record why he/ she believes that an international transaction impacts, or has the potential to impact income, provides testimony to the fact that the Indian Government is putting in checks and balances to prevent taxpayers from being saddled with unnecessary adjustments and protracted litigation, at least on issues relating to applicability or otherwise of Chapter X per se.

Situation 3: Cases set-aside by Courts

In addition to the cases that may be referred to in Situations 1 and 2 above, a case involving a TP adjustment in an earlier AY that has been fully or partially set-aside by the Tribunal, HC or SC of the said adjustment shall also invariably be referred to the TPO.

Observations:

'Set aside' would imply that although a TP issue went up for consideration to a Court, there was no finality or decision on that issue. Hence, if a similar issue arises in a subsequent AY, the case/ issue would be construed to be unresolved despite having travelled up to the Courts, and thus from the perspective of de-risking subsequent years, the CBDT may have considered it appropriate for a reference to be made in such cases/ years. It may be worth noting that the CBDT has not prescribed any monetary threshold for such cases. This is possibly because of the fact that if there is no finality or decision on a particular issue, then setting a threshold w.r.t. the value of the TP

adjustment or the underlying transaction may not be feasible.

However, having said that, the condition of 'set aside' in an earlier AY, for making a reference to the TPO, is quite open-ended and wide, and the number of cases that may fall within the ambit of this condition may in fact be quite significant. This may be so for the following reasons:

- *The condition is of set aside in an "earlier" AY, rather than in the "preceding" AY. It is quite possible that an issue may have been set aside in one of the earlier AYs – but could have been resolved in the years before or after (including the preceding AY). Therefore, simply because an issue was set aside in one of the years does not necessarily mean that it continues to be an open or unresolved issue in all years.*
- *Sometimes a 'set aside' could be with well-articulated, specific or 'in-principle' directions for resolution of a particular issue, as against a situation where 'full or partial discretion' is given to lower authorities. The CBDT has not made an exception for such cases either.*
- *Notably, unlike in Situations 1 and 2 above, the new instruction does not highlight the need, under Situation 3, for any pre-approval from the respective senior officers when referring a case to the TPO. In Situation 3, if the condition of set-aside in an earlier AY is met, then the case would "invariably" be referred to the TPO. Accordingly, there is an apprehension that such a reference may end up being more of a mechanical one.*

I. TO not permitted to determine ALP

For administering the TP regime in an efficient manner, it has been clarified that though TO has the power under section 92C of the Act to determine ALP of international transactions or SDT, determination of ALP should not be carried out at all by the TO in a case where reference is not made to the TPO. However, in such cases, TO must record in the assessment order that due to the CBDT's instruction on this matter, the TP issue has not been examined at all.

Observations:

The TO has been prevented from deciding upon any matters relating to TP. This is an imperative and welcome safeguard built in by the Indian Government in order to avoid arbitrary use of authority by a TO, particularly considering that the TO is not a TP subject-matter specialist.

II. Approval hierarchy for TPOs

If a TPO is the rank of an Additional/ Joint (CIT), then he/ she shall obtain approval of the jurisdictional CIT (TP) before passing the TP assessment order. On the other hand, if a TPO is the rank of a Deputy/ Assistant CIT, then he/ she shall obtain the approval of the jurisdictional Additional/ JCIT before passing the TP assessment order.

III. Limiting the number of cases for senior rank TPOs

The jurisdictional CIT (TP) would assign a limited number of important and complex cases, not exceeding 50, to the Additional/ Joint CIT (TPOs) working in the same jurisdiction. Appropriate guidelines shall be framed for the selection of such important and complex cases.

Observations:

Limiting the number of important and complex cases handled by TPO is undoubtedly a laudable step taken by the Indian Government, as the large number of cases being handled by TPOs with less time on hand has probably deterred them from delving into the merits of each case. This could have led to "batch processing" of cases without proper application of the mind, leading to unsustainable TP adjustments at higher judicial fora.

However, that said, 50 cases (for senior rank TPOs) may still be a large number, particularly given the fact that these 50 cases would be important/ complex in nature.

Further, even for junior rank TPOs, it would be important to prescribe a reasonable upper limit per TPO, in line with international norms (as TPO's counterparts in certain developed jurisdictions are known to handle far less cases on an annual basis).

Editor's note

The focus of the new instruction is on the mechanism of reference by a TO to a TPO. As compared to the old instruction, the mechanism for reference has now largely been made more specific, certain and rational. It is also now more risk-based and less mechanical. Further, the new instruction emphasises the need for approval

from senior officers, thereby ensuring supervisory oversight at the stage of reference itself.

While the interim instruction was an improvement over the old instruction, the new instruction is even better. The Indian Government has quite evidently taken into account the recommendations and grievances of taxpayers, and that too within a span of five months. The responsiveness of the Government is undoubtedly laudable. Further, the approach of taking into consideration taxpayer comments is clearly inclusive and collaborative, and in line with best practices followed globally – it builds trust and enhances taxpayer confidence.

On the whole, the issuance of the new instruction reflects the Indian Government's line of thinking and philosophy on different aspects as discussed in the 'Observations' above, and clearly reflects the political will to control the volume of disputes, better utilise the Revenue's resources, provide greater certainty to taxpayers, enhance international perception and invigorate the investment climate in India. However, having said that, on-ground implementation and execution remain to be seen.

APA

APA signings in India cross the '100-mark'

Press Release dated 23 September, 2016

On 23 September, 2016, the total number of APAs entered into by India's CBDT crossed the '100-mark' to reach 103.

The APA scheme was introduced in India in 2012, and the rollback provisions were subsequently introduced in 2014. With the rollback provisions being brought in, the Indian APA scheme can provide certainty for up to nine years.

Since its inception, the APA scheme has attracted tremendous interest amongst MNEs, and more than 700 applications (both unilateral and bilateral) have been filed in just four years.

The signed APAs pertain to diverse sectors and issues. Broadly, the APAs cover the following transactions – information technology support services, back office services, marketing support services, investment advisory services, contract manufacturing, contract research and development services, interest on loan, guarantee, technology royalty and management charges.

Provided below are statistics of year-wise details of APA signings in India:

Financial Year	2013-14	2014-15	2015-16	2016-17 (up to 23-09-2016)	Total
Unilateral APAs	5	3	53	38	99
Bilateral APAs	0	1	2	1	4
Total	5	4	55	39	103

Source: CBDT's press release dated 23 September, 2016 titled "Number of Advance Pricing Agreements by CBDT crosses 100."

Editor's note

The CBDT expects more APAs to be concluded and signed in the near future. The progress of the APA scheme demonstrates the Indian Government's commitment to foster a non-adversarial tax regime. Moreover, the approach and functioning of the officers in the CBDT's APA teams has been appreciated and acknowledged by the industry in India and abroad.

Case law
- Central excise
- Service tax
- VAT/ Sales tax/ Entry tax
- Customs and foreign trade policy

Key statutory updates – circulars and notifications
- Central excise
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GST updates

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Indirect Tax

Case law

Central excise

It is the responsibility of the department to prove that the advances received from the customer had an effect of depression in the sale price

2016-TIOL-07-SC-CX

The SC held that it was the responsibility of the department to establish with evidence that the advance received from the customer had an effect of depression in the sale price.

The actual cost of production without adding notional loading of 10% will be the cost in the hands of a sister unit while transferring goods for captive consumption

2016-333-ELT-287-Chennai

The larger bench of the Chennai Tribunal held that for computing the cost of production of packing material (final products), the value of intermediate goods received from a sister unit would be the actual cost of production, and not 110% of the cost of production of such goods.

CENVAT credit cannot be denied due to procedural lapse of not applying for registration as an input service distributor

Lona Industries Limited *v.* CCE [2015-TIOL-2694-CESTAT-Mumbai]

The Mumbai Tribunal held that there was no bar in the CENVAT Credit Rules on distribution of credit earned prior to taking registration by input service distributor.

No CENVAT credit on capital goods if the final product is exempted on the date of receipt of capital goods

Andhra Polymers Private Limited *v.* Commissioner of Central Excise [2016-332-ELT-831-Bangalore]

The Bangalore Tribunal held that eligibility of credit had to be determined with reference to the dutiability of the final product on the date of receipt of capital goods, and hence, credit would not be admissible if final products were exempt on the date of receipt of such capital goods.

No reversal of CENVAT credit required if the exempted product emerged as an unavoidable waste in course of manufacture of the dutiable product

In N S Ispat Private Limited *v.* CCE [2016 (335) ELT 540] & A R Sulphonates Private Limited *v.* CCE [2016-TIOL-835-CESTAT-Mumbai[

The Delhi/ Mumbai Tribunal held that a demand of 5% of the sale price was not applicable in cases where the exempted product emerged as an unavoidable waste or by-product during the course of manufacture of the dutiable product.

The proportionate credit reversal as envisaged under Rule 6(3) of CENVAT credit Rules is applicable only for common services used for both dutiable and exempted activity

Bannari Amman Spinning Mills Limited *v.* CCE & ST [2016-TIOL-2786-CESTAT-MAD]

The Madras Tribunal held that the requirement of reversal of proportionate credit was applicable only for common services used for both dutiable and exempted activity. Since the services in question were used exclusively for export of yarn and no part of the services were used for domestic clearances, the appellants were held eligible for 100% credit.

CENVAT credit of freight paid on outward transportation is allowed up to the place of buyers i.e. upto buyer's premises

CCE Dehradun *v.* Forace Polymers Private Limited [TS-352-CESTAT-2016-EXC]

The Tribunal observed that as per purchase order, the responsibility of insurance and delivery is on the vendor i.e. taxpayer and hence the amount of freight was included in the value of goods on which excise duty was discharged. Thus, Tribunal allowed CENVAT credit of service tax paid on GTA services for outward transportation of goods from factory to buyer's premises. In this case, Tribunal distinguished the Apex Court's interpretation of "place of removal" in Ispat Industries Ltd. on the ground that same pertains to inclusion of freight charges in value of excisable goods vis-à-vis the issue of availability of CENVAT credit in present case.

CENVAT credit of service tax paid on input services such as garden maintenance services, medical insurance services etc., eligible even after April 1 2011

2016-TIOL-2708-CESTAT-CHD

The Tribunal held that since the procurement of services such as medical insurance of the employees and gardening services was necessary to meet the statutorily requirements as set under Employee State Insurance Act and Pollution Control Act, respectively, the taxpayer was entitled to avail the CENVAT credit thereon, even after 01 April, 2011.

SC applies the principle of unjust enrichment to the excise duty refunds pursuant to discounts and wider interpretation has been given to the term "buyer"

Commissioner of Central Excise, Madras *v.* M/s Addison & Co Limited [2016-TIOL-146-SC-CX-LB]

The SC held that for claiming refund, the incidence of duty would not be treated as passed on if a credit note was issued to the buyer. Further, in the cases, where the buyer was claiming refund instead of the manufacturer, the buyer would also need to substantiate that he had borne the incidence of duty.

Shortfall of duty paid during a particular period can be adjusted with the excess payment made during another period

Hindustan Zinc Limited *v.* Commissioner of Central Excise [2016-336- ELT-328-Delhi]

The Delhi Tribunal held that if, on finalisation of assessment, the taxpayer was required to pay shortfall of duty during a particular period and was denied the excess payment made during another period of the same financial year, the entire purpose of keeping the assessment provisional would be rendered futile, and hence, denial of adjustment of excess and short payment of duty was held not to be tenable in law.

Premature availment of credit would only be liable to interest and there is no requirement to reverse the same under the law

Madras Cements Limited *v.* CCE [2016-336-ELT-175-Hyderabad]

The Hyderabad Tribunal held that 100% credit availed on capital goods in the first year instead of 50% was tantamount to availment of credit in advance; demand for reversal of credit could not be upheld in such case inasmuch as balance 50% credit would be admissible in the next year. Thus, the appellant was liable to pay only interest on such premature availment of CENVAT credit.

Since there is no physical removal of goods in case of transfer of division to new joint venture company, no excise duty is payable by considering the same as deemed removal

L G Balakrishnan and Bros Limited *v.* CCE [2016-TIOL-2498-CESTAT-MAD]

The Tribunal held that there was no liability to pay an amount equal to credit availed on inputs and capital goods consequent on sale/ transfer of division to new joint venture company, as there was no removal of said goods 'as such' consequent to transfer. Similarly, there was no excise duty liability on finished goods lying in stock as there was no physical clearance of excisable goods by the appellant and duty liability arises only at the time of removal from the factory.

Period of limitation not applicable in case of wrong payment of tax either under mistake of law or mistake of fact or both

G.B. Engineers *v.* Union of India [2016-VIL-305-JHR-ST]

The HC held that the claim of refund of amount paid under mistake of law or mistake of fact or both was not barred by the limitation as applicable to claim of refund of tax paid under protest. The court further observed that when there was no liability to make the payment of any amount as tax and if said amount was deposited by the taxpayer by mistake, any claim for refund could not be barred by limitation as prescribed under Section 11B of the Central Excise Act to be read with Section 83 of the Finance Act, 1994.

Authorities cannot invoke the extended period of limitation after finalisation of Audit by taking plea of 'narrow audit' plan

TS-445-CESTAT-2016-ST

The Tribunal observed that the authorities could not take a plea that since the scheme of audit envisaged special attention to large taxpayers, they have not scrutinised service

tax returns as part of audit plan, for invoking the extended period of limitation. Hence, the Tribunal set aside the order to the extent demands for wrong availment/ utilization of CENVAT credit was barred by limitation.

Service tax

Car lease provided to employees during the course of employment does not amount to services and not liable to service tax.

2015-TIOL-12-ARA-ST-AAR

The AAR held that in case of vehicles provided to employees under a “Car Lease Scheme” for the duration of their employment, the activity of “making available” a car would not amount to provision of “service,” as it would be treated as provided in the course of employment and in relation to employment, and correspondingly, would be covered under the exclusion in the definition of “service.”

Sharing of common storage facilities between companies under an agreement does not amount to provision of services by one company to another

Gujarat State Fertilizer & Chemicals Limited & Anr *v.* Commissioner of Central Excise [TS-490-SC-2016-ST]

The Supreme Court held that an arrangement for sharing of storage and handling facility between PSUs of State of Gujarat, wherein storage facility was installed at one of the PSUs premises, could not be construed as provision of storage and warehousing services by one PSU to another. SC observed that PSUs were receiving Hydro Cyanic Acid from Reliance Industries Ltd. through a common pipeline, for which handling facility was installed at one of the PSU’s premises. Hence the arrangement to share the handling and incineration expenditure equally was in the nature of joint venture and could not be treated as provision of service.

Activity undertaken by a JV partner for the mutual benefit of partnership does not amount to provision of services

Mormugao Port Trust *v.* Commissioner of Customs, Central Excise and Service Tax, Goa [2016-TIOL-2843- CESTAT-MUM]

The Goa Tribunal held that the activity undertaken was for the furtherance of the business of the joint venture (JV) did not amount to provision of services by JV partner to JV, since there was neither an intention to render a service nor was there any consideration fixed for any particular service of a partner,. Thus, it was held that the amount of royalty received by appellant from other party was not a consideration for rendition of any services but in fact represented the appellant’s share of revenue arising out of the JV being carried on by them.

Naturally bundled marketing and other support services provided on principal to principal basis should be categorised as “business support services” and not as “intermediary services”

Godaddy India Web Services Private Limited [2016-TIOL-08-ARA-ST-AAR]

The AAR held that various marketing and promotion services, supervision of third party customer care centre services, and payment processing services proposed to be provided by Godaddy India to Godaddy US were naturally bundled in the ordinary course of business, and was a single service, categorised as “business support services” and not as “intermediary services.” As the recipient of services was located outside India, the place of provision of such services would be outside India, and qualify as export of taxable services.

Part performance is said to be outside India, if employees in India provide services by accessing servers/ computers of a client outside India, hence, construed as export

2016-TIOL-415-CESTAT-Mumbai

The Mumbai Tribunal held that when employees sitting in India accessed the servers/ computer networks of clients abroad, at least part of the services could be said to have been performed outside India, and the services qualified as export of services.

Call centre services to customers of the parent entity located outside India would qualify as export even if those customers were located in India

B A Call Centre India Private Limited *v.* Commissioner of Service Tax, Gurgaon (2016-TIOL-2332-CESTAT-Delhi)

The Delhi Tribunal held that call centre services provided by the assessee to the

customers of the parent entity situated outside India had to be treated as export of services even when such customers were located in India.

While computing export turnover as well as total turnover for the purpose of refund under Rule 5 of CCR, turnover with respect to onsite services provided by branch should also be included

TS-740-CESTAT-2015-Mumbai

The Mumbai Tribunal held that the turnover of onsite services provided through an overseas branch had to be considered as export turnover as well as total turnover of the business, to determine the amount of CENVAT credit eligible for refund to the exporter of the service.

Service tax exemption notification for exemption to SEZ supplies is not valid to the extent it imposes conditions not contemplated by SEZ Act and rules framed thereunder

TS-300-CESTAT-2016-ST

The Mumbai Tribunal held that that the word ‘consumption’ in the notification 4/ 2004-ST covered utilisation of services for authorised operations by SEZ units, and did not restrict such exemption only to the extent perceived to be within the boundaries of SEZ. It was further held that as per Sec 26 of Special Economic Zones Act, 2005 (SEZ) read with section 51 & Rule 31 of SEZ Rules, 2006, unconditional exemption from statutory levies like service tax would prevail over conditional exemption provided under the Notification. Hence the exemption was held as not valid for implementation to the extent it imposed conditions not enacted in section 26 of SEZ Act, 2005 or contemplated in Rule 31 of SEZ Rules, 2006.

Education guide cannot supersede the rules framed under the law

Steps Therapeutics Limited *v.* CC, CE & ST [2016-TIOL-26-ARA-ST]

The AARs held that contents of Education Guide cannot take precedence over Place of Provision of Services (POPS) Rules. Clinical Pharmacology & Clinical Research services provided in respect of goods that were required to be made physically available by the service receiver to the applicant service provider in India were taxable in light of Rule 4 of POPS Rules, 2012.

In case of separate service tax registration for different premises, commissioner of one jurisdiction does not have power to adjudicate cases originating outside his jurisdiction

Inox Leisure Limited *v.* Commissioner of Service Tax, Mumbai [2016-TIOL-239-CESTAT-Mumbai]

The Mumbai Tribunal held that in case of separate service tax registrations for different premises, the commissioner of service tax of one jurisdiction did not have the power to adjudicate cases originating outside his jurisdiction, although the consolidated balance sheets were prepared at the head office located in his jurisdiction. In such a case, the commissioner could make show cause notices answerable to the respective jurisdictional commissioners, or seek approval from the CBEC for adjudicating the case of services rendered pan-India.

VAT/ Sales tax/ Entry tax

If goods are imported in pursuance to a contract between the importer and the ultimate consumer in India, then the sale by importer to the ultimate customer should qualify as “sale expenditure in the course of import”

TS-155-SC-2016-VAT

The SC held that the movement of goods by way of imports was in pursuance of the conditions and/ or as an incident of the contract between the importer and the ultimate customer in India. Hence, sale by importer to ultimate customer in India should qualify as “sale in the course of import.” The SC, relying on the decision in the case of M/s. K.G. Khosla & Co. *v.* Deputy Commissioner of Commercial Taxes, Madras [(1966) 3 SCR 352], further held that privity of contract between the foreign supplier and the ultimate consumer in India was not mandatory to qualify as sale in the course of import.

If the sale occasioned the movement of goods outside the state, the transaction would qualify as inter-state sales even though point of sale was within the state

2016-TIOL-1472-HC-Rajasthan-VAT

The Rajasthan HC held that supply of crude oil produced in an oilfield in Rajasthan to

central government-nominated refineries in Karnataka would qualify as inter-state sales transaction. The HC observed that even though the point of sale was within the State of Rajasthan, the transaction would qualify as inter-state sales so long as the crude oil produced in Rajasthan had occasioned the movement outside the state.

While providing pest control services, there is transfer of property in pesticides, hence, taxable as 'works contract'

Pestop [TS-499-AAR-2016-VAT]

Maharashtra Advance Ruling Authority held that pest control involved transfer of property in pesticide formulations (chemicals) and hence, liable to tax as 'works contract' under MVAT Act. The AAR observed that the term "goods" as defined in MVAT Act was very wide to include pesticides as goods. AAR further observed that in the process of implementing work order, property in goods was transferred to the consumer and therefore, applicant-dealer's contention that chemicals disappear or evaporate in the air after work, was not acceptable. AAR also reiterated that dominant intention of parties was no longer significant as State legislature was empowered to separate goods which formed part of works contract and imposed sales tax thereon.

Mere permission to use intangible rights not liable to VAT

TS-316-HC-2016-Bombay

The Bombay HC held that the franchisee agreement granting mere permission to use intangible rights was not liable to VAT. The HC observed that the agreement merely permitted the franchisee to display certain marks and to use certain technologies and methods in preparing the salads and sandwiches for sale; therefore, the consideration was not subject to VAT.

SC upholds constitutional validity of entry tax

TS-455-SC-2016

A nine-member bench of the SC upheld the constitutional validity of entry tax imposed by various states on goods coming from other states. However, the larger bench remitted the matter back to the regular bench for examination as to whether the entire State could be considered as a local area and whether entry tax could be levied on goods imported from outside the Country.

Provisions in TN VAT law restricting credit in cases of sale below purchase price are constitutional

Jayam and Company *v.* Assistant Commissioner & ANR [2016-TIOL-128-SC-VAT]

The SC upheld the constitutional validity of section 19(20) of the Tamil Nadu VAT Act, 2006, which restricted input tax credit if goods were sold below purchase price. The SC observed that it was not the right of the dealers to get the benefit of input tax credit, but it was a concession granted by virtue of section 19 of the Tamil Nadu VAT Act, 2006 and whenever concession was given by statue or notification the conditions thereof were to be strictly construed to avail such concession. The SC also held that the amendment made with retrospective effect was not valid.

Scope of levy cannot be extended by adding an explanation to the charging section

State of Tamil Nadu *v.* Taher Ali Industries and Projects Private Limited [2016-TIOL-2556-HC-MAD-CT]

The HC observed that an explanation should be read in harmony with the main section and should be issued to clear the ambiguity, if any, appearing in the main section. The HC held that addition of any explanation which sought to widen the scope of charging section was *ultra vires* and held to be unconstitutional.

Customs and foreign trade policy

Benefit given under any exemption notification cannot be withdrawn by issue of a circular

2016-TIOL-327-CESTAT-Mumbai

The Mumbai Tribunal held that an importer would be allowed SAD refund by way of re-credit in reward scrips, when the SAD was paid by using such reward scrips. The principle was that a right given under any exemption notification could not be taken away by issue of a circular.

No loading on the basis of identical goods if there is difference in the commercial level and quantity of goods imported

2016-TIOL-205-CESTAT-Delhi

The Delhi Tribunal held that customs authorities could not impose loading on the basis of identical goods in case there was a difference in commercial levels and in quantity of goods imported in terms of Rule 4 of the Customs Valuation Rules, 2007.

If there is no restriction on the importer to purchase raw material necessarily from a related overseas supplier, royalty paid to them is not includible in value of imported raw material

Schenectady Herdillia Limited *v.* CC (2016 (335) ELT 525), Kalyani Brakes Limited *v.* CC [2016-TIOL-1696-CESTAT-Mumbai], Rhone Poulenc (I) Limited *v.* CC [2016 (335) ELT 122]

The Mumbai Tribunal held that royalty for technical know-how was not includible in the value of imported raw material in case there was no condition in the import agreement to purchase raw material necessarily from a related overseas supplier.

In case of a 100% EOU, there is no need to interfere with SVB order as there is no impact in payment of customs duty due to increase in valuation

Commissioner of Customs *v.* ASB International Private Limited [2016-TIOL-1392-Mumbai]

The Mumbai Tribunal held that in case the importer was a 100% EOU, there was no need to interfere with the special valuation branch order accepting value of imported goods even when there was a payment of technical assistance fee, since there was no impact on customs duty payment due to increase in valuation.

Export made during intervening period of making application and issuance of advance license not to be considered towards fulfilment of export obligation

Rotomac Electricals Limited *v.* Union of India [2016 (336) ELT 390-Delhi]

The Delhi HC held that exports made after filing of application and before the date of issuance of advance licence could not be considered in fulfilment of export obligation under the advance licence scheme.

Key statutory updates – circulars and notifications

Central excise

Insertion of sunset clause of 31 March, 2016 for excise exemption benefit in the state of J&K and denial of benefit to goods that only undergo processes ancillary to manufacture

Notification no. 03/ 2016-CE dated 22 January, 2016

The excise exemption available to new units set up/ units undertaking substantial expansion/ units making new investment to generate additional employment in the state of Jammu and Kashmir is restricted to units commencing commercial production/ undertaking substantial expansion/ making investment to generate employment, on or before 31 March, 2016.

Further, the exemption under these notifications is no longer available to goods that have only undergone processes ancillary to manufacture such as preservation during storage, cleaning, sorting, declaration or amendment of MRP, etc.

Services by way of sale of dutiable goods on commission basis to be included in the explanation to the definition of input services and CENVAT credit cannot be used for payment of SBC

Notification no. 02/ 2016-Central Excise (N.T.) dated 03 February, 2016

CENVAT Credit Rules have been amended to include an explanation in the definition of input service, to clarify that sales promotion includes services by way of sale of dutiable goods on commission basis. The rules have been further amended to provide that CENVAT credit cannot be used for making payment of Swachh Bharat Cess.

Payments made under Rule 6(3) shall not exceed total of (i) opening balance of input and input services available at the beginning and (ii) taken during the period, for which payment relates

Notification no. 23/ 2016-Central Excise-NT dated 01 April, 2016

For a person removing non-exempted as well as exempted goods, or providing non-exempted as well as exempted services, and

opting to pay 6%/ 7% of the value of exempt turnover, the upper limit of such payment has been amended to "sum total of opening balance of credit of inputs and input services available at the beginning of the period to which the payment relates and the credit of inputs and input services taken during that period" as compared with previous upper limit of "total credit available in the account of the taxpayer at the end of the period to which the payment relates."

Service tax

Refund of service tax paid on services used beyond the factory or any other place or premises of production or manufacture of the said goods, for their export

Notification no. 01/ 2016-Service Tax dated 03 February, 2016

The scheme of grant of rebate of service tax paid on input services by exporters of goods under notification no. 41/ 2012-ST has been amended. Presently, services used beyond the place of removal, as per the Central Excise Act, were eligible for rebate. Now, the eligibility of rebate has been extended to services used beyond the factory or any other place or premises of production or manufacture of the said goods, for their export. Further, the rate at which rebate is granted under the notification (when claiming rebate at specified rates, instead of on actual basis) is increased, considering the increase in service tax rates.

Services provided by the government or local authorities to a business, except the services specifically exempted, will be liable to service tax under reverse charge

Notification nos. 6 & 7/ 2016-Service Tax dated 18 February, 2016 and Notification nos. 22-24 & 26/ 2016-Service Tax, 24/ 2016-Central Excise (NT) and Circular no. 192/ 02/ 2016 - Service Tax dated 13 April, 2016

With effect from 01 April, 2016, all services provided by the government or local authorities to a business entity (with turnover exceeding INR1 million in preceding financial year), except the services specifically exempted or covered by any other entry in the negative list, were made liable to service tax under reverse charge. The CBEC also issued clarifications on service tax applicability on services provided by the government or local authority.

Levy of Krishi Kalyan Cess

With effect from 01 June, 2016, Krishi Kalyan Cess is levied on all taxable services at an effective rate of 0.5% of the value of taxable services.

Change in service tax treatment (B2B and B2C) of online information/ cloud services

Notification nos. 46-48-2016-ST and Circular No. 202/ 12/ 2016-Service Tax all dated 09 November, 2016

The ambit of online information and database access and retrieval services has been significantly expanded.

The place of provision for import of online information and database access and retrieval services has been changed to default rule for B2B transactions, which results in change in tax position, and would now entail payment of service tax on reverse charge basis in case of import of such services.

In case of B2C services, where service providers who are not located in India, they or their agents would be required to pay service tax in India by obtaining registration, and also file their service tax returns.

Customs and FTP

Relaxation in documentation while applying for IEC

Notification no. 34/ 2015-2016, dated 29 January, 2016

The central government has notified that only three documents (i.e., digital photograph of the signatory applicant, copy of PAN card and a cancelled cheque) need to be uploaded along with the application for obtaining the importer exporter code.

CBEC revamps the customs special valuation branch mechanism

Circulars nos. 04/ 2016-Customs and 05/ 2016-Customs, dated 09 February, 2016

The central government has comprehensively revised its instructions for examination of related party import transactions as trade facilitation measures.

Introduction of definition of e- commerce in FTP 2015-2020

Notification no. 02/ 2015-2020, dated 11 April, 2016

The central government has defined "e-commerce" in foreign trade policy as buying and selling of goods and services, including digital products, conducted over digital and electronic networks. Further, for the purpose of Merchandise Exports from India Scheme (MEIS), "e-commerce" has been defined as the export of goods, hosted on a website accessible through the Internet to a purchaser.

CBEC removes customs bonding requirement for EOUs

Notification no. 44/ 2016-Customs dated 29 July, 2016 and Circular no. 35/ 2016-Customs dated 29 July, 2016

The CBEC has issued a notification removing the requirement of customs bonding for export oriented units, software technology park units and electronics hardware technology park units (collectively referred to as "EOU units"). It has also issued a circular clarifying these changes.

VAT/ CST/ Professional tax/ Entry tax

Exemption from VAT to new establishments under electronics and IT and ITeS Investment policy in the State of Chhattisgarh

Notification no. F1014/ 2016/ CT/ V (50) dated 13 April, 2016

Effective 13 April, 2016, dealers establishing units under the Electronics, IT and ITeS Investment policy of Chhattisgarh are exempted from VAT for five years from the date of commencement of commercial production or up to the date of Goods and Service Tax coming into force, whichever is earlier.

Rajasthan introduced a unified common refund application form for VAT, CST, entry tax and luxury tax.

Circular no. 07/ 201617 F.16 (95)/ Tax/ CCT/ 1415/ 1169 dated 8 August, 2016

A unified common refund application form for VAT, CST, entry tax and luxury tax has been introduced in the State of Rajasthan.

Uttar Pradesh levies entry tax on goods purchased or ordered through online shopping or e-commerce and brought into the state.

Notification no. K.A. NI-2-1342/ XI-9(107)/ U.P. Act-30-07-Order-(166)-2016 dated 21 September, 2016

Effective 22 September, 2016, entry tax is to be levied on goods purchased or ordered through online shopping or e-commerce and brought into the state (otherwise than in connection with business or personal use) at the rate of 5% of the value of goods.

GST updates

Moving ahead in the direction of rolling over GST with effect from 01 April, 2017, the current year saw various steps.

- The Constitution was amended to enable the introduction of GST.
- The GST Council was set up to take various decisions.
- The Draft Model GST law was released by the government in June 2016 and a revised version of the law was released in November 2016.

The draft law is a model law that the central government and each of the state governments would use to draft their respective central and state GST Acts. It contains comprehensive provisions of Central/ State GST (CGST/ SGST). The law and rules covers various aspects relating to the supply of goods and services, time and place of such supply, input tax credit, valuation rules, tax administration and transition provisions. Further, a draft of the Integrated GST Act, which will govern the levy of GST on inter-state supplies by the central government was also issued. In addition to the model GST law, draft rules to determine the value of the taxable supplies for levy of GST were also made available in June, which were not released in November.

Draft rules issued by the government for registration, invoicing and payment (26 September, 2016) and for refunds and returns (27 September, 2016) and subsequently approved by the GST Council.

The central government has issued draft rules for registration, invoicing, payment, refunds and returns, including the applicable formats of the forms, under the GST regime,

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for comments. The rules were discussed and approved by the GST Council but the final version has not been released.

Four-tier tax structure finalised.

The GST council finalised a four-tier rate structure, proposing to levy GST on various products as under:

- Zero tax rate – essential items would be zero rated/ exempted
- 5% – This would include goods of common consumption and essential commodities.
- 12% and 18% – these would be the standard rate of tax for goods.
- 28% – other goods, including the goods currently taxed at 30-31% [excise 12.5 + VAT 15%], will be taxed at 28%.
- Cess – an additional cess would be levied on the luxury and demerit goods such as aerated beverages, *pan masala*, tobacco and luxury cars.
- Effective rate of tax on services are expected on be in the same lines as mentioned above.
- Rate for gold would be decided separately.
- The items to be covered in each category would be decided separately by revenue secretaries, who would then provide a report on the same to the Council.

The process of enrolment of taxpayers under the GST regime has commenced from 08 November, 2016.

Notifications and circulars

- Startup
- FEMA
- Foreign direct investment
- Banks
- Transfer of shares
- Companies Act

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Regulatory

Notifications and circulars

Startup

Startup India – Action Plan

Action Plan dated 16 January 2016

Prime Minister Shri Narendra Modi unveiled an Action Plan for Startups on 16 January, 2016, highlighting various initiatives and schemes being proposed by the Government of India to build a strong eco-system for nurturing innovation and empowering startups in the country. The Action Plan proposes a 19-point action list that will, among others, enable setting up of incubation centres, easier patent filing, tax exemption on profits, setting up a INR100 billion corpus fund, ease of setting-up of business, and a faster exit mechanism.

The DIPP conducted an event on 16 January, 2016 to celebrate the entrepreneurial spirit of India's youth. The event was a day-long workshop attended by notable persons from the startup community. The closing session was addressed by Shri Narendra Modi, Prime Minister of India, who unveiled the Startup India Action Plan.

Key highlights

The Action Plan is an initiative of the Government of India to build a strong eco-system for nurturing innovation in order to accelerate economic growth and generate employment opportunities.

For this purpose, "startup" has been defined to mean an entity incorporated or registered in India, with an annual turnover not exceeding INR250 million in any preceding FY, and working towards innovation, development of new products, or services driven by technology or intellectual property. Additionally, it has been provided that the entity:

- should not be formed by splitting up, or reconstruction, of a business already in existence;
- shall cease to be a startup if its turnover exceeds INR250 million in any preceding FY, or if it has completed five years from the date of incorporation/ registration.
- will be eligible for tax benefits only after a certificate is obtained from the Inter-Ministerial Board set up by the DIPP for this purpose.

The key proposals of the Action Plan are as follows:

General Initiatives

Compliances based on Self-Certification

- Compliance pertaining to six labour and three environmental laws will be allowed to be self-certified through the Startup mobile app.
- No inspections will be carried out under labour laws for a three-year period.
- Startups classified under "White Category" as defined by the Central Pollution Control Board will be allowed self-certification under environmental laws, with only random checks proposed.

Startup India hub

- Government to set up a Startup India Hub that will be a single-point of contact for Startups.
- Such a hub will enable knowledge exchange by collaborating with various stakeholders such as the Central and State Governments, legal partners, consultants, universities, and R&D institutions, and assist in the funding process.

Establishment of Fund of Funds with a corpus of INR100 billion

- Government to set up a fund with an initial corpus of INR25 billion and a total corpus of INR100 billion over a period of four years.
- This fund will not invest into startups directly, but shall be a part of the capital of SEBI-registered venture funds.
- This fund will be managed by a Board with private professionals from industry bodies, academia, and successful startups.
- The venture fund may obtain up to a maximum of 50% of the fund size from the Fund of Funds, provided it has already raised the balance 50% of the stated fund size.

Credit Guarantee Fund for Startups

- Credit Guarantee Fund aims to catalyse entrepreneurship through credit to innovators across all sections of society.
- The Credit Guarantee mechanism shall be rolled out through the National Credit

Guarantee Trust Company/ SIDBI with a budgetary corpus of INR5 billion per year for the next four years.

Startup fests

- Introduction of startup fests to bolster the startup ecosystem and provide a platform to showcase ideas and work to a larger audience.
- As a part of the "Make in India" initiative, the Government proposes to hold one fest at the national level and one at the international level in an international city on an annual basis.
- Such fests would help in showcasing innovation and provide a platform for collaboration, thereby connecting with investors, mentors, incubators, exhibitions, product launches, etc.

Launch of Atal Innovation Mission (AIM)

AIM proposes to promote entrepreneurship through Self-Employment and Talent Utilisation (SETU), wherein innovators would be supported and mentored to become successful entrepreneurs. This would be achieved through the following:

- Establishment of sector-specific incubators;
- Establishment of 500 tinkering labs;
- Pre-incubation training
- Strengthening of existing incubation facilities;
- Seed funding to high-growth startups.

AIM also proposes to promote innovation through the following:

- Institution of innovation awards (Three per State/ UT and Three at the national level);
- Providing support to State Innovation Councils for awareness creation and organising state level workshops/ conferences;
- Launch of Grand Innovation Challenge Awards for finding low-cost solutions to India's pressing problems.

Setting up of Incubators

- To leverage private sector expertise in the setting-up of incubators, it is proposed that 35 new incubators will be set up in existing institutions.
- Funding support of 40% (subject to a maximum of INR0.1 billion) is proposed to be provided by the Central Government for establishment of new incubators in existing institutions; balance funding to be committed by the respective State Government and private sector.
- 35 new private sector incubators will also be set up with a grant of 50% (subject to a maximum of INR0.1 billion) provided by the Government.

Innovation centres

- In order to augment incubation and R&D efforts, 31 centres of Innovation and entrepreneurship will be set-up/ scaled up for providing facilities to over 1,200 startups at national institutes.
- These 31 centres will include 13 startup centres and 18 technology business incubators to be set up/ scaled up at IIMs/ NITs/ IITs.

Research Parks

- Seven new research parks are proposed to be set up with an initial investment of INR1 billion each.
- These parks shall enable companies with a research focus to set up base and leverage the expertise of academic/ research institutions.

Promote entrepreneurship in biotechnology

- 5 new bio clusters, 50 new bio incubators, 150 technology transfer offices and 20 bio connect offices will be established though Biotechnology Research Assistance Council (BIRAC).
- Biotech Equity Fund would be set up in partnership with national and global equity funds to provide financial assistance to young Biotech startups.

Innovation focused programs for students

- Innovation core program shall be initiated targeting school kids with an outreach of 1 million innovations from 0.5 million schools. Further, 10,000 innovations will be provided prototyping support and the top 100 would be showcased at the Annual Festival of Innovations at the Rashtrapati Bhavan.
- A Grand Challenge Program – NIDHI (National Initiative for Developing and

Harnessing Innovations) to be initiated to support and award INR1 million to 20 student innovations from Innovation and Entrepreneurship Development Centres.

- Uchhattar Avishkar Yojana scheme will have an earmarked fund of INR2.5 billion per annum towards fostering "very high quality" research among IIT students.

Annual Incubator Grand Challenge

- In order to assist in building world-class incubators, the Government proposes to initially identify and establish ten incubators with financial assistance of INR0.1 billion each.
- Further, an annual "Incubator Grand Challenge" will be held to identify incubators that can become world class.

Regulatory

Mobile App and Portal

A mobile app and portal would be launched by 01 April, 2016 to provide on-the-go accessibility for:

- Registration of startups through a simple form and obtaining a certificate.
- Filing of compliances and obtaining information on various clearances/ approvals/ registrations.
- Provision of a platform for collaborating with other stakeholders such as venture funds, incubators, academia, mentors etc.
- Applying for various schemes of the Government under the Startup India initiative.

Faster Exit for Startups

- The Insolvency and Bankruptcy Bill 2015 (IBB), will allow fast track and/ or voluntary closure of businesses.
- Startups satisfying the specified conditions of the IBB will be allowed to wind up in 90 days on a fast-track basis.
- Such a wind up will be carried out by an insolvency professional who will be in charge of the company and oversee the liquidation process.

Legal support and fast-tracking patent application

Startup Intellectual Property Protection (SIPP) scheme will be introduced on a pilot basis for a one year period to facilitate the filing of patents, trademarks and designs. The scheme would include the following:

- Fast-tracking patent application.
- Setting up a panel of "Facilitators" who will advise on different IPR and also provide advice on promoting and protection of IPRs in overseas jurisdictions.
- Such Facilitators will also provide end-to-end advisory from making applications till the final disposal of the IPR application.
- The Government will bear the cost of such Facilitators, and the startups shall bear only the cost of the applicable statutory fees.
- A rebate of 80% on patent filing fees *vis-à-vis* other companies is proposed.

Relaxed Norms of Public Procurement for startups

- Startups (in the manufacturing sector) shall be exempted from the criteria of "prior experience/ turnover" in tenders floated by any government entity or PSU without any relaxation in quality standards or technical parameters.
- Startups will have to demonstrate their capability to execute the project as per requirements and should have their own manufacturing facility in India.

Tax

Capital gains tax exemptions

- A capital gains exemption mechanism has been proposed for investors (class of investors to be specified) investing in the Startup ecosystem.
- Capital gains invested in "Fund of Funds" recognised by the Government shall be exempted.
- Further, existing capital gains exemption for investment in newly formed manufacturing Micro, Small and Medium Enterprises (MSMEs) by individuals shall be extended to all startups.
- For startups, investment in computer or computer software (used in core business activity) to qualify as purchase of "new assets."

Income-tax exemption for three years

- Income-tax exemption proposed for startups for a period of three years.
- Exemption subject to non-distribution of dividend by the Startup.

Tax exemption for investments made above FMV

- Investments made by incubators in startups proposed to be insulated from the rigors of section 56(2)(viib) of the Act. Any consideration received by startups for issuance of shares over FMV to incubators not to be taxed in the hands of the startup.
- The term "incubator" is yet to be defined for the above purpose.

Editor's note

Startup India campaign is being lauded for attempting to bring startups to the centre stage of India's growth story. The Action Plan has certainly addressed key concerns, such as simplifying the process to obtain certain regulatory registrations and approvals by rolling out the proposed mobile app and portal, enabling faster exits from a regulatory perspective, providing funding support and credit guarantee for startups, and permitting certain specified tax benefits. While the Action Plan is certainly a welcome and positive step towards the philosophy of promoting startup innovation in the country, it will also be important to consider tax exemptions for angel investors, seed capital funds and stock options offered by startups to employees. Additionally, the Government should consider providing indirect tax incentives for startups. The details of the tax exemptions are likely to be announced in the upcoming Union Budget.

FEMA

FEMA 20 – Amendment in Regulations

Notification Nos. FEMA.361/ 2016-RB and 362/ 2016-RB dated 15 February 2016

The DIPP had released Press Note 12 dated 24 November, 2015, liberalising the FDI Policy in 15 major sectors of the economy. Changes introduced in the policy include increase in sectoral caps, bringing activities under the automatic route, and easing of conditions for foreign investment (you may refer to our news alert dated 26 November, 2015). Further, changes were made in relation to foreign investment by NRI *vide* Press Note 07 of 2015 dated 03 June, 2015. The RBI has now notified these changes (*Notification Nos. FEMA.361/ 2016-RB and 362/ 2016-RB dated 15 February, 2016*).

Further, the RBI had permitted foreign investments under the automatic route in Investment Vehicles (you may refer to our news alert dated 20 November, 2015). The new notifications provide that the Sponsor, Manager and Investment Manager can be organised in the form of a LLP, and downstream investment by an Investment Vehicle shall be regarded as foreign investment if either the Sponsor or the Manager or the Investment Manager is not Indian 'owned and controlled'.

The above-mentioned notifications shall be effective from the date of their publication in the Official Gazette, i.e., 15 February, 2016.

Key Highlights of Press Note 7 of 2015 dated 03 June, 2015 are as follows:

- The definition of NRI was amended to mean an individual resident outside India who is a citizen of India or is an OCI cardholder within the meaning of section 7 (A) of the Citizenship Act, 1955. PIO cardholders registered as such under Notification No. 26011/ 4/ 98 F.1, dated 19 August 2002, issued by the Central Government are deemed to be OCI cardholders.
- Investment by NRI non-repatriation basis is deemed to be domestic investment at par with the investment made by residents.

Additional key changes in FEMA 20 *vide* above-mentioned notifications are summarised below:

1. Foreign investment in Investment Vehicles – AIFs, REITs, InvITs and other entities regulated by the SEBI or any other authority designated for such purpose
    - Sponsor, Manager, Investment Manager can be organised in the form of an LLP.
    - Downstream investment by an Investment Vehicle shall be regarded as foreign investment if either the Sponsor or the Manager or the Investment Manager are not Indian 'owned and controlled' as defined in Regulation 14 of the principal Regulations.

    Earlier, the wording was "Downstream investment by an Investment Vehicle shall be regarded as foreign investment if neither the Sponsor nor the Manager nor the Investment.

Manager is Indian 'owned and controlled' as defined in Regulation 14 of the principal Regulations."

2. Foreign investment by NRIs:

- General – Under repatriable basis and non-repatriable basis

  i. Investment permitted in securities or units (previously only shares or convertible debentures). As per revised Schedule 3 and 4, this should now include shares/ CCPS/ CCDs/ warrants/ units of an investment vehicle.

  ii. NRI investment cap of 5% in shares/ CCPs/ CCDs/ warrants will be applicable only to investments made under repatriable basis.

- NRI investment under repatriable basis

  i. Require compliance with FDI policy.

- NRI investment under non-repatriable basis

  i. Clarified that investment in shares/ units/ LLP/ partnership or proprietary firm can be made without any limit.

  ii. Prohibition to invest in Nidhi Company or a company engaged in agricultural/ plantation activities or real-estate business or construction of farm houses or dealing in Transfer of Development Rights continues.

  iii. Revised definition of "real-estate business" to be used. Additionally, investment in units of SEBI registered REITs forms part of the exclusions to the definition, and hence, are permitted.

3. Following conditions have been deleted:

- Shares cannot be issued under FDI route (other than in compliance with downstream investment regulations) with a view to acquiring the existing shares of an Indian company.

  "Provided that the shares or convertible debentures are not being issued by the Indian company with a view to acquire existing shares of any Indian company. However, downstream investment by an Indian Company receiving FDI would be permitted to the extent specified in Regulation 14."

- Previously, an Indian Company proposing to issue shares to a person resident outside India against shares swap required prior approval of FIPB. While this requirement was removed by Press note 12 of 2015, the narrow meaning of shares swap provided in the conditions also stands deleted.

  "Indian company proposing to issue shares to a person resident outside India against shares swap i.e. in lieu of consideration to be paid for shares acquired in the overseas company."*

Foreign direct investment

Guidelines for FDI in E-commerce – An attempt to clarify the ambiguities in e-commerce space

Press Note No. 3 (2016 Series) dated 29 March, 2016

To settle the ongoing debate around ambiguities on the concept of B2C e-commerce, the DIPP has issued a Press Note today clarifying that 100% FDI is permitted in e-commerce business operated under the marketplace model. This also enables such entity to undertake support services such as warehousing, fulfilment, collections and call-centre services. However, it places certain obligations such as restricting single vendor sale to 25%. Further, FDI is still not permitted in the inventory based model.

Definitions

E-commerce – buying and selling of goods and services, including digital products over digital and electronic network.

E-commerce entity – a company incorporated under the Companies Act 1956 or 2013, or a foreign company covered under section 2 (42) of the Companies Act, 2013, or an office, branch or agency in India covered under section 2 (v)(iii) of FEMA, owned or controlled by person resident outside India, and conducting e-commerce.

Inventory based model of e-commerce – The inventory of goods and services is owned by e-commerce entity and is sold to consumers directly.

Marketplace based model of e-commerce – Providing information technology platform by an e-commerce entity on a digital and electronic network to act as a facilitator between buyer and seller.

Entry Route

- 100% FDI under automatic route is permitted in the marketplace model of e-commerce
- FDI is not permitted in the inventory-based model of e-commerce.
- Subject to conditions of FDI Policy on services sector and applicable laws, sale of services through e-commerce will be under the automatic route.

Conditions on Marketplace model

- Permitted activities:
  i. providing support services to different sellers in respect of warehousing, logistics, order fulfilment, call centre, payment collection and other services.
  ii. entering into transactions with different sellers registered on its platform on B2B basis.
- Restrictions on the following:
  i. Ownership of inventory purported to be sold in the marketplace.
  ii. Having more than 25% of its sales from one vendor or group company(ies).
  iii. Directly or indirectly influencing the sale price of goods/ services.
- Details with regards to name, address and other contact details of the seller to be clearly made available.
- Post sales, delivery of goods to customers, and customer satisfaction to be the responsibility of the seller.
- Any warranty/ guarantee of goods and services sold to be the responsibility of the seller.
- Payments for sale of goods/ services may be facilitated by the entity in conformity with RBI guidelines.
- Guidelines on cash-and-carry wholesale trading as given in para 6.2.16.1.2 of the FDI Policy will apply to B2B e-commerce.
- Digital and electronic network used for e-commerce business will include network of computers, television channels and any other internet application used in automated manner such as web pages, extranets, and mobiles.

Editor's note

After multiple stakeholder discussions and considering submissions pursuant to the 2013 Discussion Paper, the Government has attempted to define e-commerce models and put in place parameters to ensure that the policy aligns with other sectors placed under the FDI Policy.

Radical changes in FDI policy

The Indian Government continues the flurry of policy liberalisations with the objective of providing major impetus to employment and job creation in India. Some of the key FDI policy liberalisations announced are set out below:

Single Brand Retail Trading

Local sourcing norms applicable for proposals with FDI exceeding 51% have been relaxed. For Single Brand Retail Trading of products having 'state-of-art' and 'cutting edge' technology, eight- year relaxation regime is proposed. It is not clear whether the proposed three-year relaxation would apply to all product categories or only to products having 'state-of-art' and 'cutting edge' technology.

Broadcasting Carriage Services

Teleports (setting up of up-linking Hubs/ Teleports), DTH, Cable Networks, Mobile TV, Headend-in the Sky Broadcasting Service will now be under the automatic route upto 100%, which was earlier restricted to 49% .

FIPB approval, however, would be required in situations where the license already exists in the Company and it is now seeking either foreign investment resulting in change in the ownership pattern, or where there is transfer of stake by existing investor to new foreign investor.

Brownfield Pharma

FDI upto 74% would now be permitted under automatic route in brownfield pharmaceuticals. Any investment above 74% would require prior Government approval.

Defence Manufacturing

As per the present FDI policy, foreign investment beyond 49% is permitted in defence manufacturing under the Government approval route, on a case-to-case basis, wherever the investment is likely to result in access to modern and 'state-of-art' technology in the country.

The condition of investment resulting in state-of-art technology beyond 49% has been eliminated.

Further, the FDI limit for the defence sector has also been made applicable to the manufacturing of Small Arms and Ammunitions covered under the Arms Act 1959.

Civil Aviation Sector

100% FDI now permitted under automatic route in Brownfield Airport.

Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline and regional Air Transport Service

100% FDI now permitted. Government approval required for FDI beyond 49%.

No change in policy on NRI and foreign airlines.

Private Security Agencies

FDI limit raised to 74% (automatic route upto 49%). Increase in limit to 74% will require an amendment in Private Security Agencies (Regulation) Act, 2005.

Animal Husbandry

Requirement of 'controlled conditions' has been eliminated. However, FDI cap remains the same, i.e., 100% under automatic route for Animal Husbandry (including breeding of dogs), Pisciculture, Aquaculture and Apiculture.

FDI in Food Products

It has now been decided to permit 100% FDI under government approval route for trading, including through e-commerce, in respect of food products manufactured or produced in India.

Establishment of branch office, liaison office or project office

In addition to the above FDI Policy changes, processes for establishment of offices in India have been simplified for Defence, Telecom, Private Security or Information and Broadcasting. Where an FIPB approval license/ permission by the concerned Ministry/ Regulator has been granted, further RBI approval/ security clearance will not be required.

NBFC amendment in regulations for foreign investment in NBFCs

Press Information Bureau Press Release dated 10 August 2016

The Ministry of Finance has issued a Press Release dated 10 August, 2016 reporting that the Union Cabinet has given its approval to amend the regulations for foreign investment in NBFCs on the following key aspects:

1. Under the present regulations on "NBFCs", FDI is allowed in only 18 specified activities under the automatic route, after fulfilling prescribed minimum capitalisation norms mentioned therein. In his Budget 2016-17 Speech, the Finance Minister had announced that "FDI will be allowed beyond the 18 specified NBFC activities under the automatic route in other activities which are regulated by financial sector regulators".

   As per the Press Release, FDI is allowed under the automatic route for all "Other Financial Services" provided that such services are regulated by any regulators (RBI, SEBI, PFRDA, etc.)/ Government Agencies. Foreign investment in "Other Financial Services" that are not regulated by any regulators/ Government Agency, can be made under the approval route.

2. Additionally, minimum capitalisation norms as mandated under the FDI policy have been eliminated, as most regulators have already fixed minimum capitalisation norms.

Banks

RBI Guidelines for 'on tap' licensing of Universal Banks in the private sector

RBI releases Guidelines for 'on tap' Licensing of Universal Banks in the Private Sector dated 01 August, 2016

The RBI has released the final guidelines (2016 guidelines) for 'on tap' licensing of Universal Banks in the Private Sector on 01 August 2016 – the licensing policy is a change from the current 'Stop and Go' policy where RBI opens the window for bank licences for a limited period. As full-fledged bank licensing will now be on-tap, applications can be submitted to RBI at any time – applicants not found suitable for grant of approval under the 2016 guidelines, however, will not be

eligible to make an application for three years from the date of the RBI decision.

The 2016 guidelines, mostly in line with the draft guidelines issued in May 2016, lay down the rules for eligible promoters, corporate and holding structure requirements for setting-up the bank, corporate governance, prudential and exposure norms, and process that will be followed by RBI for taking the decision on the applications submitted to it. Unlike the previous guidelines issued in February 2013 for licenses of Universal Banks (2013 guidelines), RBI has now made the Non-operating Financial Holding Company (NOFHC) structure optional for individual promoters and standalone promoting/ converting entities, instead of making it mandatory.

The summary of the 2016 guidelines and a comparison chart of key changes between the 2013 and 2016 guidelines is as follows:

Eligible Promoters

- Individuals/ professionals who are residents (as defined in FEMA Regulations) and having 10 years of senior level banking and finance experience.
- Entity/ group in private sector that are 'owned and controlled by residents' and having a successful track record of at least 10 years provided the following-
  i. Non-financial business of such entity/ group should not account for 40% or more in cases where total assets of the entity/ group is more than INR 50 billion.
- Existing NBFCs that are 'owned and controlled by residents' and having a successful track record for at least 10 years.

'Fit and Proper' criteria

The Promoter/ Promoter Groups should be 'fit and proper', which would be assessed by the RBI on the basis of the following:

- Having a past record of sound credentials and integrity
- Should be financially sound and should have a successful track record for at least 10 years
- In case of individuals – to have minimum 10 years of senior level experience in banking and finance
- In case of entities/ NBFCs – to have minimum 10 years of experience in running its/ their businesses, financially sound, etc.

Preference will be given to promoting entities having diversified shareholding.

The terms 'Promoter' and 'Promoter Group' have been defined in the guidelines.

Corporate structure

- Structure without NOFHC
  i. NOFHC not mandatory where individuals or standalone promoting/ converting entities do not have any other group entities and do not propose to establish any other entity after the bank is incorporated.
  ii. In case of setting up or conversion to a bank, any change in shareholding of 5% or more within promoting entity/ converting entity from date of application to be reported to RBI.
- Structure with NOFHC
  i. NOFHC to be registered with RBI as an NBFC.
  ii. NOFHC to be held only by individuals, non-financial services entities and Core Investment Companies/ investment companies in the Promoter/ promoter group to hold at least 51% of the total voting equity shares of the NOFHC.
  iii. In case of individuals (belonging to promoter group) holding more than 51% of the shareholding of NOFHC – shareholding by each such individual along with his/ her relatives and entities in which promoters/ relatives hold greater than 50% shares, is capped at 15%.
  iv. Non-promoter holding restricted to 49% of the total voting equity shares of NOFHC.
    – In case of individuals (not being a promoter) – shareholding by each such individual along with his/ her relatives and entities in which such individual/ relatives hold greater than 50% shares, is capped at 10%.
  v. Only promoters/ promoter group should have significant influence and control (As defined under Accounting Standards 21 and 23) in the NOFHC.

vi. NOFHC should hold the bank as well as other regulated financial services entities of the group (in which individual promoters/ group has significant influence or control).

vii. NOFHC shall not be permitted to set up new financial services entity for three years, except where Subsidiary/ Joint Venture/ Associate of bank is legally required or permitted by RBI.

viii. Activities that can be conducted departmentally by the bank or through separate structure, viz., Subsidiary/ Joint Venture/ Associate (as required by RBI) may be carried out through separate financial entities under NOFHC. However, promoters desiring to continue existing specialised activities from a separate entity proposed to be held under NOFHC, can do so with prior RBI approval.

ix. Activities not permitted to the bank would also not be permitted to be undertaken by entities under the NOFHC.

x. Corporate structure should not impede ring-fencing of the financial services entities held by the NOFHC.

xi. Entities held by NOFHC should be regulated by respective regulators on solo basis.

xii. Any change in shareholding within the NOFHC that results in acquisition/ transfer of equity capital in excess of 5% of NOFHC will have to be with prior RBI approval.

Non-promoters' holding in the bank

- No single entity or group of related entities permitted to have shareholding or control, directly or indirectly, in excess of 10% during the first five years of bank's operations
- Large industrial houses (means a group with assets of INR50 billion or more with the non-financial business of the group accounting for 40% or more in terms of total assets or gross income) permitted to only own equity up to 10% of the bank on an aggregate basis (without any controlling interest).

Capital requirements

- Minimum capital of INR5 billion; minimum net worth of INR5 billion at all times (also applicable to NBFCs converting into banks).
- 40% of the paid up capital should be held by NOFHC which shall be locked in for five years; NOFHC to continue its holding to 40% for any increase in capital within five years.
- Shareholding in excess of 40% should be brought down to 40% within 5 years, to 30% within 10 years and to 15% within 15 years.
- Bank should maintain a minimum capital adequacy ratio of 13% of its risk weighted assets for at least three years, subject to upward revision by RBI.
- On a consolidated basis, NOFHC should maintain a minimum capital adequacy as per Basel norms applicable to the entity.
- The bank to be publicly listed within six years of commencement of business.

Foreign shareholding

- Governed by existing FDI policy subject to minimum promoter shareholding indicated in these guidelines.
- Aggregate foreign shareholding should not exceed 74% (under automatic route up to 49%).

Other key considerations

- 25% of new branches in unbanked rural areas with a population of less than 9,999 as per the latest census.
- Corporate governance, cross-holding norms, prudential and exposure norms, including PSL targets as applicable shall need to be adhered to.
- The bank to maintain arms-length relationship with Promoter/ Promoter Group entities and major suppliers (major suppliers and major customers of the promoter group would mean dealings with those who constitute 10% or more of annual purchases or sales or both taken together) and major customers of these entities.
- Prior approval required for any acquisition of shares/ compulsorily convertible debentures/ bonds/ voting rights where holding aggregates to 5% or more of paid-up equity capital or voting rights of the bank.

Procedure for application and RBI decision

- The licensing window will be open on-tap
- A realistic and viable business plan (addressing how the bank proposes to achieve financial inclusion) to be submitted along with application
- Post initial screening by RBI, applications will be referred to a SEAC
- Standing External Advisory Committee (SEAC) will submit its recommendations to the Internal Screening Committee (ISC), consisting of the Governor and the Deputy Governors
- ISC will submit its recommendations to the Committee of the Central Board of the RBI for final decision to issue in-principle approval (valid for 18 months)
- Applicants aggrieved by RBI decision may appeal within one month from the date of receipt of communication
- Applicant not found suitable for grant of approval will not be eligible to make an application for three years from the date of RBI decision.

Comparison between 2016 and 2013 guidelines

Parameter	2016 Guidelines	2013 Guidelines
Eligible Promoters	• Individuals/ professionals (residents) with 10 years of senior level experience in banking and finance • Entities/ group in private sector (that are resident owned and controlled) with successful track record of at least 10 years; Non-financial business of such entity/ group should not account for 40% or more in cases where total assets of the entity/ group is more than INR50 billion. • Existing NBFCs (that are resident owned and controlled) with successful track record for at least 10 years; above condition of 40% threshold from non-financial business applicable where NBFC is part of promoter group.	• Entities/ group in private sector (that are resident owned and controlled) and entities in public sector • Promoter/ promoter group with existing NBFC
NOFHC shareholding	• NOFHC not mandatory for individuals/ standalone promoters/ converting entities that do not have other group entities • At least 51% shareholding to be held by Promoter/ promoter group (preferably with diversified shareholding). • Shareholding by each individual belonging to promoter group in NOFHC – 15%	• Promoter/ Promoter Group to set up bank only through NOFHC • NOFHC to be 100% owned by Promoters/ group (company with 51% public shareholding) • Shareholding of each individual belonging to Promoter group in NOFHC – 10%
'Fit and Proper' criteria	In addition to the conditions stated in February 2013 guidelines, individual promoters should also have a minimum 10 years of senior level experience in banking and finance	Individual promoters to have a past record of sound credentials and integrity, be financially sound and have successful track record of running their business for minimum 10 years
Timeframe for public listing	Within six years of commencement of business	Within three years of commencement of business

Parameter	2016 Guidelines	2013 Guidelines
Dilution of stake	Promoter shareholding to be diluted to: • 30% in 10 years • 15% in 15 years	Promoter shareholding to be diluted to: • 20% in 10 years • 15% in 12 years
Foreign shareholding	As per current FDI regulations (74% in aggregate)	Permitted only up to 49% in aggregate for the first five years from date of licensing
NBFC branches	RBI will consider allowing conversion of all NBFC branches to bank branches, only with prior RBI approval.	Tier 2 to 6 – Automatic conversion to bank branches Tier 1 – Prior RBI approval required to convert to bank branches
Application screening process	• Application to be reviewed by (in given order) – Initial screening by RBI; – Standing External Advisory Committee; – Internal Screening Committee (consisting of Governor and Deputy Governor); and – Committee of Central Board of RBI • Applicants not found suitable – not eligible to make an application for banking license for 3 years from date of rejection • Aggrieved applicants – Can prefer appeal against RBI's decision to RBI's Central Board of Directors within one month of such communication	High Level Advisory to review application

Revised Guidelines for sale of stressed assets by banks

Circular No. RBI/ 2016-17/ 56 DBR. No.BP.BC.9/ 21.04.048/ 2016-17 dated 01 September 2016

The RBI has issued a notification outlining revised guidelines on the sale of stressed assets by banks. Key highlights of the revised guidelines are provided below:

Stringent provisioning for investment in SRs of stressed assets sold by banks

- W.e.f 01 April, 2017, where a bank's holding is more than 50% of security receipts (SRs) of stressed assets sold by the bank itself, provisioning rate would be the same as if the loans notionally continued in bank's books or the provisioning rate after considering actual NAV, whichever is higher.
- W.e.f. 01 April, 2018, the above threshold of 50% would stand reduced to 10%.

Sale of stressed assets

- RBI has directed banks to have detailed Board-approved policies and guidelines in place regarding sale of stressed assets.
- Right of First Refusal (ROFR): The ARC that holds the highest and a significant share (~25%~30%) of stressed assets would have the ROFR for acquiring the asset by matching the highest bid. This is aimed at facilitating faster aggregation of debt.
- Adoption of Swiss Challenge Method for sale: A prospective buyer may offer a bid for stressed assets. In case the bid qualifies the conditions laid down by the bank's Board, then the bank may invite counter-bids from other prospective buyers. Ultimate sale may be to the ARC holding highest share (subject to matching the highest bid), the original bidder, or the highest bidder.
- In case the bank does not sell the stressed asset after receiving bids (as above), then it would be required to immediately create a provision on the asset after considering the discount on book value quoted by the highest bidder, or provision as per current provisioning norms, whichever is higher.

Prospective buyers

- Prospective buyers need not be restricted to ARCs – banks may also consider other banks, financial institutions, NBFCs, etc. who have necessary capital and expertise to resolve stressed assets.
- Minimum two weeks should be allowed for due diligence by buyers.

Identification of stressed assets

- The head office/ corporate office of the banks should be actively involved in the identification of stressed asset beyond a specified value.
- All 'doubtful assets' above a threshold amount should be periodically reviewed by the Board/ Board Committee (at least once in a year) for determining the assets for sale – the rationale for exit or otherwise would need to be documented by the banks.

Valuation

- In case of exposures beyond INR50 crore (i.e., INR500 million), banks should obtain two external valuation reports at banks' own cost.
- The discount rate used in valuation subject to a floor of contracted interest rate and penalty, if any.

Buy-back of restructured assets

- RBI has clarified that banks are not prohibited from taking over standard accounts from ARCs where ARCs have successfully implemented a restructuring plan, subject to appropriate due diligence and other conditions.
- However, a bank can never take over the assets they have themselves earlier sold to ARCs.

Disclosure requirements for banks

Banks would be required to disclose the aging schedule of the SRs held by them including the provision made in relation to such SRs.

Transfer of shares

Cross border transfer of shares of an Indian company permitted on deferred basis

Currently, transfer of shares or convertible debentures requires prior approval of the RBI in case there is deferment of consideration.

Recent relaxation

The RBI has now permitted transfer of shares on a deferred basis, subject to compliance with following conditions:

- Maximum 25% of the total consideration can be paid by the buyer on a deferred basis
- The total consideration paid for shares must be compliant with applicable pricing guidelines
- The parties can enter into an escrow arrangement for the consideration payable on deferred basis
- If the total consideration is paid, the seller can furnish an indemnity for the amount of consideration payable on deferred basis
- The consideration payable on deferred basis should be paid within a period of 18 months from date of transfer agreement. Additionally, the escrow arrangement/ period of indemnity cannot exceed 18 months.

The above conditions need to be complied with for transfer of shares on a deferred basis between a resident buyer and a non-resident seller, or *vice versa*.

Editor's note

The relaxation will simplify transactions in the secondary space that commercially require part consideration to be deferred.

Companies Act

For all Companies Act related updates please refer to our M&A chapter.

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PwC Thought Leadership Articles

Sn	Date of publication	Particulars of Articles/ TL Publication	Where published	Author names
1	01 December 2015	Tax rules you must know if you work abroad	Financial Chronicle	Gireesh Shetty and Parineeta Lala
2	14 December 2015	Why India's most important tax reform is still stuck in Parliament	Quartz	Gautam Khattar, Kishore Kumar and Vidushi Gupta
3	27 December 2015	Taxation: Kuldip Kumar	Business Standard	Kuldip Kumar
4	03 January 2016	Make the system efficient, effective, flexible and fair	Business Standard	Anita Rastogi and Denis McCarthy
5	12 January 2016	Taxing daily allowance of outbound employees	Financial Chronicle	Sandip Mukherjee and Vibha Bhaskar
6	15 January 2016	Taxation of dividend income	ITRAF	Indraneel Roy Chaudhury, Saurav Bhattacharya and Gaurav Kumar Goyal
7	31 January 2016	India GST - the Home Stretch	BNA Bloomberg	Vivek Mishra and Nandita Nawalakha
8	01 February 2016	Making Dispute Resolution Mechanisms more effective	The Chamber's Journal	Kuntal Sen and Anand Kankani
9	08 February 2016	Make your housing loan save tax for you	Financial Chronicle	Chander Talreja
10	16 February 2016	Will GST see the light of day next fiscal?	The Financial Express	Gautam Khattar, Kishore Kumar and Vidushi Gupta
11	16 February 2016	Budget wishlist: Real estate sector	Business Standard	Abhishek Goenka
12	17 February 2016	Budget cafe 2016: A roadmap for long term stability	The Financial Express	Arvind Srivatsan and Rajat Ranjan
13	18 February 2016	Budget 2016 should look at ensuring success of REITs	Economic Times	Abhishek Goenka
14	18 February 2016	Delhi High Court rules on taxability of transponder hire charges	Taxmann	Frank D' Souza, Pavan R Kakade and Puneet Putiani
15	19 February 2016	Budget wishlist: Telecom sector	Business Standard	Sandeep Chaufla
16	22 February 2016	Budget 2016: Just get set for stricter tax laws, more disclosures	Economic Times	Kuldip Kumar
17	02 March 2016	Budget to boost infra, farm sectors	Business Standard	PwC India analysis

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18	02 March 2016	Emphasis is on PM's key initiatives	Business Standard	PwC India analysis
19	07 March 2016	The REIT way for recapitalizing Indian banks	Livemint	Vivek Mehra
20	08 March 2016	Nine Transformation pillars in budget	Economic Times	Gautam Mehra, Akash Gupt, Sandeep Ladda and Rahul Garg
21	09 March 2016	Incentivising the oil & gas sector	The Financial Express	Ajay Rastogi
22	10 March 2016	CountrybyCountry Reporting: Blind men and an elephant	The Financial Express	Bipin Pawar and Manish Sabharwal
23	11 March 2016	What is in REITs for you?	The Financial Express	Hemal Uchat and Bhavin Vora
24	12 March 2016	Industry-stifling move	Financial Chronicle	Dhiraj Mathur
25	14 March 2016	Readers Corner Taxation	Business Standard	Kuldip Kumar
26	16 March 2016	A block builder budget	The Financial Express	Shyamal Mukherjee and Suraj Malik
27	27 March 2016	Readers Corner Taxation	Business Standard	Kuldip Kumar
28	28 March 2016	Analyse tax impact before you invest	Financial Chronicle	Vikas Kumar
29	05 April 2016	Government needs to come clear on Equalisation Levy	Economic Times	Sandeep Ladda and Milan Shah
30	07 April 2016	The Bangalore ITAT order attempts to settle the anomaly of extension of stay of demand beyond 365 days	The Financial Express	Kanchun Kaushal and Ravi Sharma
31	22 April 2016	Taxing Government services	The Financial Express	Anita Rastogi and Preetam Singh
32	26 April 2016	Choose the correct income tax return form	Financial Chronicle	Ravi Jain
33	28 April 2016	REITs will assist in streamlining the real estate sector	Forbes India	Abhishek Goenka and Pallavi Garg
34	29 April 2016	Action plan 14 – Making dispute resolution mechanisms more effective	The Chamber's Journal	Kuntal Sen and Anand Kankani

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35	05 May 2016	A peep into the future with the blast from the past	Taxmann	Aravind Srivatsan, Ragini Satnalika and Paravathy Vikram Kumar
36	07 May 2016	Tuning India to POEM	Taxmann	Rahul Garg and Parul Ghosh Dastidar
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44	24 May 2016	Implications of India tightening treaty framework with Mauritius	The Financial Express	Suresh Swamy, Siddharth Ajmera and Ketki Shah
45	29 May 2016	Readers' Corner: Taxation	Business Standard	Kuldip Kumar
46	30 May 2016	Rules for determination of fair market value in case of indirect transfer Computational Analysis	Taxmann	Amit Bahl, Harsh Biyani and Surbhi Bagga
47	31 May 2016	Reporting of personal assets	Financial Chronicle	Ishita Sengupta and Paras Doshi
48	01 June 2016	New Guidelines for 'Grant of Stay' - A welcome move by CBDT	Taxmann's Corporate Professionals Today	Bikash Jain
49	03 June 2016	Draft rules for 'indirect transfer' valuation	Taxmann	Pavan Kakade and Punit Singh Putiani

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51	06 June 2016	Buyback - A smart way of rewarding shareholders?	Orange Taxsutra	Yogesh Dharnidharka and Jainee Seth
52	13 June 2016	Deferral of tax on deferred consideration	The Financial Express	Alok Saraf
53	20 June 2016	Jobwork transactions under model GST law	Taxmann	Pulak Saha and Shrenik Mehta
54	25 June 2016	Model GST law - Feast after a decade of fast	Taxmann	Anita Rastogi and Preetam Singh
55	30 June 2016	Tax refunds are debts owed by revenue	Taxmann's Corporate Professionals Today	Shilpi Varma and Vineet Jain
56	01 July 2016	Indian Startups at cross roads – Falling valuations exposed to incometax	Taxmann	Sandeep Ladda, Milan Shah, Rachna Gurnani and Yatin Damania
57	01 July 2016	Draft rules for taxing "Indirect Transfer" : At sixes and sevens	Moneycontrol.com	Falguni Shah and Jayesh Sanghvi
58	05 July 2016	Rules for taxing indirect transfers : Keeping finger on pulse	Moneycontrol.com	Falguni Shah and Jayesh Sanghvi
59	08 July 2016	DT Dispute Resolution Scheme and Income Declaration Scheme	WIRC Reference Manual	Faizan Nursumar and Parin Sangoi
60	08 July 2016	Clarifications required in Income Tax Dispute Resolution Scheme 2016: PwC	Economic Times	Vishal Anand and Shubhabrata Mukherjee
61	10 July 2016	Readers Corner Taxation	Business Standard	Kuldip Kumar
62	15 July 2016	Final Rules to determine FMV for indirect transfer An insight into	Taxmann	Amit Bahl, Harsh Biyani and Surbhi Bagga
63	15 July 2016	Relaxation to non-residents from higher WHT rate in the absence of PAN	Taxmann	Ankur Kansal and Jasmeet Kohli
64	16 July 2016	The changing tax paradigm	Financial Chronicle	Suresh Swamy

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65	16 July 2016	How Krishi Kalyan cess vitiates against Make in India, Startup India	The Financial Express	Anita Rastogi and Prashant Gupta
66	18 July 2016	# Support GST : Bill to propel policy dream initiatives of Narendra Modi and govt	Firstpost	Anita Rastogi and Preetam Singh
67	22 July 2016	SB ruling on base erosion - 5 questions to ponder	Taxsutra	Sanjay Tolia, Darpan Mehta, Ruhi Mehta, Gaurav Shah and Umesh Agarwal
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70	25 July 2016	Things to remember before filing ITR this year	Financial Chronicle	Vikas Kumar
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72	04 August 2016	Are fund managers heading home?	The Financial Express	Gautam Mehra and Nehal Sampat
73	04 August 2016	GST-the last mile!	The Financial Express	Pratik Jain
74	05 August 2016	GST: Game changer	Livemint	Pratik Jain, Abhishek A Rastogi and Prashant Gupta
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76	05 August 2016	Preparation is key for a smooth transition to GST	Livemint	Anita Rastogi and Preetam Singh
77	10 August 2016	“GST from April feasible, but will test industry’s mettle”	The Hindu - Business Line	Pratik Jain
78	12 August 2016	Draft Rules on buy-back of shares - An insight into	Taxmann	Amit Bahl, Harsh Biyani and Amit Khemka
79	14 August 2016	Readers Corner Taxation	Business Standard	Kuldip Kumar
80	15 August 2016	India-Singapore Tax Treaty: Relax-it or tax-it?	Economic Times	Ketan Dalal and Bhavin Shah

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82	18 August 2016	Buy Back tax bites	The Hindu - Business Line	Abhishek Goenka and Sriram Ramaswamy
83	23 August 2016	Retail's GST worries	The Financial Express	Pramod Banthia, Feneel Shah and Ankit Bachhawat
84	02 September 2016	Draft Rules on Buy Back Tax - Drawing a Line in the Sand...	Taxsutra	Hiten Kotak and Falguni Shah
85	05 September 2016	Textile industry may face the GST jolt	The Financial Express	Kunal Wadhwa
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93	30 September 2016	Is April 2017 deadline for GST a reality?	Financial Chronicle	Amit Bhagat and Sahil Sood
95	01 October 2016	Still a work in progress	Infrastructure Today	Pratik Jain
94	04 October 2016	Decoding revised ICDS - Tangible Fixed Assets and Borrowing Costs	Taxsutra	Hitesh Sawhney and Ashish Singhal
96	05 October 2016	What does GST need to take off? Find out here	The Financial Express	Pratik Jain

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99	21 October 2016	Chinks still remain in revised ICDS	The Financial Express	Hitesh Sawhney
100	21 October 2016	GST cess confusion: Focus should be having most products at 18% rate	The Financial Express	Pratik Jain
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104	14 November 2016	Final rules on buyback provisions: Tax issues on M&A, Esop, sweat equity get cleared; some worries remain	Economic Times	Rekha Bagry & Manjit Bhimajiani
105	16 November 2016	Being GST ready!	Taxmann	Pulak Saha and Shrenik Mehta
106	17 November 2016	Reader's Corner Taxation	Business Standard	Kuldip Kumar
107	22 November 2016	Tax pacts and India: Bye bye, treaty shopping	The Financial Express	Abhishek Goenka
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112	29 November 2016	TP aspects of Business restructuring - Navigating uncharted territory	Taxsutra	Darpan Mehta, Mohit Parekh and Sayli Chemburkar

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Sn	Date	Issue	Ruling/ Notification/ Circular
1	01 December 2015	Exempt capital gains excluded from'accumulated profit' for deemed dividend; deemed dividend provisions cannot be applied to non-shareholder family members	I.T.A. No. 1703 & 2015/ Kolkata/ 2014
2	02 December 2015	'Notional' acquisition cost of rights not treated as cost of related party transaction that has no purpose	TS-666-HC-2015
3	02 December 2015	ECB Policy – New Framework	Exchange Commercial Borrowings (ECB) Policy – Revised Framework published vide A.P. (DIR Series) Circular No. 32 dated 30 November 2015
4	03 December 2015	SEBI notifies new Listing Regulations	CIR/ CFD/ CMD/ 16/ 2015
5	03 December 2015	Upfront premium received for leasing out land on BOT basis taxable on receipt basis	TS-674-ITAT-2015
6	04 December 2015	Key recommendations of the panel on GST rates	
7	04 December 2015	Draft model GST law made available	
8	11 December 2015	CBDT comes up with a new facility for pre-filling TDS data while submitting online rectification application to Income-tax department	
9	14 December 2015	Delhi HC rules on marketing intangibles in case of licensed manufacturers	ITA No. 110/ 2014 & 710/ 2015
10	16 December 2015	Safe Harbour Rules - Recommendations	
11	17 December 2015	Radio programme production for broadcasting tantamounts to manufacture – therefore, eligible to claim additional depreciation	TS-708-HC-2015
12	21 December 2015	Indian distributor of airtime held to create a Dependent Agent PE of foreign channel owner in India	TS-714-ITAT-2015
13	25 December 2015	CBDT issues draft guidelines for determination of POEM	

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14	07 January 2016	FATCA & CRS update: CBDT issues updated Guidance Note for implementation of rules for FATCA & CRS reporting in India	Guidance Note implementation of reporting requirements under Rules 114F to 114H of the Income-tax Rules, 1962 updated as on 31 December 2015
15	12 January 2016	CBDT amends rules for furnishing information regarding payments to non-residents	Notification No. 93/ 2015 (F. No. 133/ 41/ 2015-TPL)
16	18 January 2016	FAQs with regard to CSR under section 135 of the Companies Act, 2013	Circular No. 01/ 2016
17	18 January 2016	Startup India – Action Plan	
18	19 January 2016	Carry-forward and set-off of unabsorbed losses not permissible on change in shareholding by over 49% even if transaction is intra-group	ITA 349/ 2015 and ITA 388/ 2015
19	20 January 2016	Income tax Simplification Committee First Report and Recommendations	
20	21 January 2016	Buy-back under an HC-approved scheme not reorganisation within meaning of exception under Article 13(5) of India-Netherlands tax treaty	TS-10-ITAT-2016 (Mumbai-Tribunal)
21	22 January 2016	Transfer of shares of Indian company from Mauritius to Singapore within the group held not taxable; Revenue's contention that transfer is scheme for tax avoidance rejected	TS-15-AAR-2016 (AAR)
22	22 January 2016	Consideration for offshore activities in connection with exploration, prospecting and production of mineral oil is taxable in India	TS-773-AAR-2015 (AAR)
23	25 January 2016	Two more modes of generating EVC for paperless return filing notified	Notification No. 1/ 2016 dated 19 January 2016
24	01 February 2016	EPFO releases consolidated guidelines on PF compliances in respect of outbound assignees	http:/ / epfindia.coM/site_docs/ PDFs/ Circulars/ Y2015-2016/ IWU_Compliance_EPF_36602.pdf
25	03 February 2016	Consideration received for executing turnkey contract not taxable in India in absence of Permanent Establishment in India	ITA No. 143-144/ 2013

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26	04 February 2016	CBEC makes amendments in service tax exemption and CENVAT Credit Rules	CBEC Notification Nos. 1-3/ 2016-Service Tax and 2/ 2016-Central Excise (N.T.), both dated 3 February, 2016
27	06 February 2016	Government issues procedures for e-hearing for paperless assessments	Notification No. 2/ 2016
28	08 February 2016	MAT credit, advance tax and withholding tax of demerged undertaking allowed to resulting company on demerger on pro rata basis	I.T.A Nos. 2241 & 2516/ Ahd/ 2011
29	15 February 2016	CBEC revamps the Customs Special Valuation Branch mechanism	Circulars Nos. 4/ 2016-Customs and 5/ 2016-Customs, both dated 9 February, 2016
30	16 February 2016	Loss on sale of shares within lock-in period to group company disallowed and held as sham transaction	TS-57-ITAT-2016 (Delhi-Tribunal)
31	16 February 2016	New tax treaty signed between Australia and Germany – First tax treaty incorporating recommendations of BEPS Action Plans	
32	19 February 2016	FATCA & CRS update: CBDT issues clarification for FATCA & CRS implementation in India	F.No. 504/ 090/ 2007-FTD-I
33	19 February 2016	CBEC notifies effective date for increase in the gamut of services provided by the Government that are subject to service tax	Notification No. 6/ 2016-Service Tax dated 18 February, 2016
34	20 February 2016	Indian Government puts limit on early withdrawal from provident fund	Notification No. G.S.R. 158(E), dated 10 February, 2016 [F.No. S-35012/ 5/ 2015-SS-II]
35	22 February 2016	Significant changes in the 2016 US Model Income Tax Convention	
36	24 February 2016	FEMA 20 – Amendment in Regulations	Notification Nos. FEMA 361/ 2016-RB and 362/ 2016-RB dated 15 February 2016

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37	03 March 2016	Clarification on applicability of withholding tax on payments made to production houses and advertisement agencies	Circular No. 4/ 2016 and Circular No. 5/ 2016
38	05 March 2016	Benefit of India-UK tax treaty to UK Partnerships clarified	
39	08 March 2016	CBDT lays down four attributes for not characterising a consortium as AOP	CBDT Circular No. 7 of 2016 dated 7 March, 2016
40	09 March 2016	Enhanced threshold limits for, and exemption from applicability of, Combination provisions under the Competition Act, 2002 notified	F. No. 5/ 33/ 2007-CS
41	09 March 2016	Government announces intention to roll back budget proposals relating to taxability of Recognised Provident Fund	
42	14 March 2016	CBDT issues revised and updated guidance for implementation of TP provisions	Instruction No. 3 of 2016 on 10 March 2016
43	16 March 2016	Subsidies were in the nature of cost reimbursement, and had direct nexus with undertaking's activities; hence eligible for inclusion in profits for computing deduction under sections 80-IB/ 80-IC	TS-124-SC-2016 (SC)
44	17 March 2016	EPFO notifies date of entry into force of social security agreement with Australia	http:/ / www.epfindia.coM/site_docs/ PDFs/ Circulars/ Y2015-2016/ IWU_AustraliaAgrement_24955.pdf
45	17 March 2016	Fund management activities - Safe Harbour Rules prescribed	
46	18 March 2016	Compensation paid by developers to tenants for alternative accommodation not in nature of rent; section 194-I of Act inapplicable	I.T.A. No. 5963/ Mumbai/ 2013
47	19 March 2016	Payments under non-exclusive license towards the right to use information embedded in the copyrighted product not taxable as "royalty"	TS-131-ITAT-2016 (Hyderabad-Tribunal)
48	22 March 2016	CBDT notifies rule to clarify that pre-conversion period is includible in period of holding of shares acquired on conversion of debentures/ bonds into shares	Notification No. 18/ 2016 dated 17 March 2016

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49	23 March 2016	Fair market value of shares of a private company, for recipient taxation, to be computed as per the rule prescribed even if shares are transferred at a different value	TS-129-ITAT-2016 (Hyderabad-Tribunal)
50	28 March 2016	Delhi Tribunal upholds crew service providers' claim for deemed income tax regime under section 44BB; income for period when vessel was outside Indian territorial waters held taxable	I.T.A No. 4542/ Del/ 2013
51	30 March 2016	Guidelines for FDI in E-commerce– An attempt to clarify the ambiguities in e-commerce space	
52	01 April 2016	Loss on transfer of division debited to Income Statement not to be added back for computing Book Profit for MAT, if accounts prepared in accordance with Companies Act requirements	[2016] 67 taxmann.com 281 (Calcutta)
53	02 April 2016	Payment made by company to acquire ROFR for acquiring a controlling interest in its promoter's new initiative is not royalty paid to the promoter; no tax to be withheld under section 194J	[2016] 67 taxmann.com 321 (Bangalore-Tribunal)
54	02 April 2016	Government notifies new income tax return forms for FY 2015-16	Notification No. 24/ 2016, dated 30 March 2016
55	04 April 2016	Unclaimed relief can be sought through a revision application to CIT under section 264; Benefit of substantive law cannot be taken away by TO on mere technicalities – TOs not to take advantage of taxpayer's error or mistake	TS-163-HC-2016 (Delhi)
56	04 April 2016	FATCA & CRS update: CBDT releases utility tool for FATCA & CRS information reporting	
57	05 April 2016	EPFO puts on hold new provident fund withdrawal provisions till 30 April 2016	WSU/ 27(1)2016/ Paragraph-68NNNN/ 166
58	05 April 2016	Government notifies new income tax return forms for AY 2016–17	Notification No. 24/ 2016, dated 30 March, 2016
59	06 April 2016	Capital gains on transfer of development rights is to be computed by considering market value of land as per municipal records as the full value of consideration; cost of construction of share of built-up area is not relevant	TS-148-ITAT-2016(Bangalore-Tribunal)

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60	07 April 2016	Purchase method of accounting upheld in case of merger of wholly owned subsidiaries into parent company; Regional Director's objection thereto rejected	LSI-1019-HC-2016 (Bombay)
61	15 April 2016	Madras HC dismisses writ petition challenging notification of Cyprus as Notified Jurisdictional Area under section 94-A	TS-197-HC-2016 (Madras)
62	15 April 2016	CBEC issues clarifications on service tax applicability on services provided by Government or local authority	Ref: Notification Nos. 22-24/ 2016-Service Tax, 24/ 2016-Central Excise (NT) and Circular No. 192/ 02/ 2016-Service Tax dated 13 April, 2016
63	18 April 2016	Up front charges paid by SEZ co-developer towards allotment of land under 99-year lease along with certain rights is not 'rent' and does not require tax deduction at source	TS-189-HC-2016 (Madras)
64	20 April 2016	Draft Foreign Tax Credit Rules released	
65	20 April 2016	Government rolls back restrictions on early withdrawal from provident fund	
66	21 April 2016	AAR rules coring services taxable under section 44BB of the Income-tax Act, 1961	TS-208-AAR-2016 (AAR)
67	24 April 2016	Taxability in case of conversion of firm into company under Part IX of the Companies Act, 1956	[2016] 66 taxmann.com 249 (Gujarat)
68	24 April 2016	Mumbai Tribunal holds channel subscription payments and carriage fees liable to withholding tax under section 194C	TS-216-ITAT-2016 (Mumbai-Tribunal)
69	26 April 2016	Loan waiver a taxable benefit/ perquisite; absence of 'the' before 'business' influences section 28(iv) interpretation	[2016] 68 taxmann.com 289 (Madras)
70	29 April 2016	In JDAs, capital gains are taxable only if all conditions of s.53A of TOPA fulfilled; developer to demonstrate willingness to perform its obligations under development agreement	ITA Nos. 1944 to 1949/ Mds/ 2013 [TS-213-ITAT-2016 (Chennai-Tribunal)]

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71	29 April 2016	Tips are not hotel employees' salary income as employment contract is not proximate cause for such receipts	TS-225-SC-2016 (SC)
72	02 May 2016	No tax to be withheld on commission paid to non-resident agent even in cases where orders ultimately secured from Indian company	[TS-230-ITAT-2016 (Pune-Tribunal)]
73	03 May 2016	Delhi High Court rules that refund cannot be adjusted against outstanding demand without prior intimation to taxpayer	[W. P. (C) 683/ 2016]
74	04 May 2016	Government rolls out instructions relating to the new income-tax forms notified for the financial year 2015-16	
75	04 May 2016	CBDT clarifies that income/ loss arising from transfer of unlisted shares to be considered under head "Capital Gain" irrespective of holding period, with certain exceptions	Circular No. 6/ 2016 dated 29 February, 2016
76	04 May 2016	Singapore tax resident company held to be beneficial owner of royalty and interest; treaty benefits allowed though remittance made in subsequent year	ITA No. 233/ PN/ 2014
77	04 May 2016	CBDT notifies new form for reporting employee claims and tax saving investments, amends withholding tax rules and forms	Notification No. 30/ 2016, dated 29 April, 2016
78	05 May 2016	Taxability Of Deferred Consideration	[2016] 68 taxmann.com 319 (Bombay)
79	07 May 2016	Tribunals ruling favorably on the issue of corporate guarantees; primarily on legal arguments	
80	09 May 2016	AMP adjustment in case of licensed manufacturer with large turnover and a fully operational manufacturing, marketing and distribution system in India struck down	TS-194-ITAT-2016 (Mumbai-Tribunal)
81	10 May 2016	Amendments to the Finance Bill, 2016 as passed by the Lok Sabha	

Sn	Date	Issue	Ruling/ Notification/ Circular
82	10 May 2016	Delhi High Court rules that income received by US Telecom Equipment supplier not taxable in India as no part of such income attributable to operations carried out in India	TS-241-HC-2016 (Delhi)
83	11 May 2016	CBDT specifies procedure for online submission of e-TDS/ e-TCS statements, Forms 15G/ 15H and authorised dealers' foreign remittance statements	Notification No. 6/ 2016, 7/ 2016, 8/ 2016 [F. No. DGIT(S)/ ADG(S)-2/ TDS e-filing Notification/ 110/ 2016
84	12 May 2016	Protocol for amendment of India – Mauritius tax treaty signed	
85	13 May 2016	No PE where threshold limit under Article 5(2)(i) of Indo-Mauritius treaty not met for each project independently	ITA No. 4028/ Mum/ 2002
86	13 May 2016	Framework for computation of book profit for the purpose of levy of MAT for Ind AS compliant companies - Committee recommendations	
87	16 May 2016	SEBI issues guidelines for public issue of units by InvITs	
88	18 May 2016	Receipts under 'Management and Administrative Services Agreement' for provision of composite services constitute royalties for a UK resident taxpayer	IT(TP)A No.6/ Bang/ 2011
89	19 May 2016	Delhi HC quashes reassessment on US company as activities of Indian affiliate alleged to constitute a PE were already subject to TP in India	TS-267-HC-2016 (Delhi)
90	19 May 2016	Intra-group services to pass "need, evidence or rendition, and benefit" tests	TS-216-ITAT-2016 (Delhi-Tribunal)
91	20 May 2016	Forex loss on borrowings allowed as revenue expenditure as it has direct nexus with interest cost savings, held not covered by section 43A	TS-265-ITAT-2016 (Pune-Tribunal)
92	23 May 2016	Processing of returns and grant of consequential refunds cannot be denied citing pendency of scrutiny proceedings as reason	[2016] 69 taxmann.com 226 (Delhi)

Sn	Date	Issue	Ruling/ Notification/ Circular
93	23 May 2016	“Income-diversion” principle inapplicable where shareholders directly received consideration on sale of company’s undertaking under a Scheme of Arrangement	ITA No. 12/ 2003
94	24 May 2016	Madras High Court rules that income-tax refund is a ‘debt claim’ due from the Government and interest thereon exempt under Article 12(3) of India-Italy tax treaty	TS-279-HC-2016 (Madras)
95	25 May 2016	Draft Rules released on computation of income attributable to indirect transfer of assets	F No 142/ 26/ 2015-TPL dated 23 May, 2016
96	25 May 2016	Government notifies valuation rules and issues FAQs on the Income Declaration Scheme, 2016	Notification No. 33/ 2016, F.No. 142/ 8/ 2016-TPL, dated 19 May, 2016; Circular No. 16 and 17 of 2016, dated 20 May, 2016
97	25 May 2016	Cross border transfer of shares of an Indian company permitted on deferred basis	
98	26 May 2016	Tribunal analyses newly inserted Explanation 2 to section 263 – opines on its scope and retrospective application	ITA Nos. 2690/ Mum/ 2016 & 2691/ Mum/ 2016
99	27 May 2016	CBEC clarifies many issues on Krishi Kalyan Cess	Notification Nos. 27-31/ 2016-Service Tax, Notification No. 28/ 2016-Central Excise (N.T.); Circular No. 194/ 04/ 2016-ST, all dated 26 May, 2016
100	31 May 2016	CBDT instructs that bad debt claims be allowed even if debt not established to be irrecoverable	Circular No. 12/ 2016
101	01 June 2016	CBDT notifies Equalisation Levy Rules, 2016	
102	01 June 2016	Government notifies the Direct Tax Dispute Resolution Scheme Rules, 2016	Notification No. 35/ 2016
103	02 June 2016	MCA constitutes NCLT and NCLAT and notifies certain provisions of Companies Act, 2013 to make them operative	Notification Nos. S.O.1935(E) & 1932(E)

Sn	Date	Issue	Ruling/ Notification/ Circular
104	02 June 2016	Distribution of income by trust to beneficiaries not chargeable to tax under section 56(2)(vi)	ITA No. 1594/ Bangalore/ 2014
105	02 June 2016	Receipt of bonus shares not subject to tax under section 56(2)(vii)	TS-299-ITAT-2016 (Bangalore-Tribunal)
106	07 June 2016	Consideration for installation services integral to contract for construction work not taxable as royalty or FTS in absence of PE of taxpayer in India	W.P. (C) 7416/ 2012
107	07 June 2016	CBDT amends rule for disallowance of expenditure relatable to exempt income	Notification No. 43/ 2016 dated 2 June, 2016
108	08 June 2016	Share application money not share capital, interest thereon a revenue expenditure	TS-304-ITAT-2016 (Pune-Tribunal)
109	09 June 2016	CBDT clarifies applicability and scope of recent amendment to TCS provisions relating to sale of motor vehicles	
110	10 June 2016	Delhi High Court holds that no service tax can be levied on sale of flats under construction	TS-231-HC-2016 (Delhi)-ST
111	14 June 2016	Development rights not transferred by member of AOP (formed only for efficient pooling of resources) not to be taxed under section 45(3)	TS-313-ITAT-2016 (Pune-Tribunal)
112	14 June 2016	Draft Model GST law issued	
113	17 June 2016	SEBI releases Consultation Paper on continuous disclosures to be made by InvITs	
114	20 June 2016	Radical changes in FDI policy regime	
115	22 June 2016	Decoding the draft Model GST law - Impact on Real Estate sector	
116	22 June 2016	Decoding the draft Model GST law - Impact on Aviation sector	
117	22 June 2016	Decoding the draft Model GST law - Impact on the Pharma sector	
118	22 June 2016	Decoding the draft Model GST law - Impact on the FMCG sector	

Sn	Date	Issue	Ruling/ Notification/ Circular
119	22 June 2016	Decoding the draft Model GST law - Impact on the Transport and Logistics sector	
120	22 June 2016	Decoding the draft Model GST law - Impact on Automobile sector	
121	23 June 2016	‘Appointed date linked to Effective date’ in merger scheme–which was contingent on receipt of RBI license – Scheme allowed by High Court	
122	24 June 2016	Members of employees’ pension scheme will get extra benefit if they opt to defer withdrawal	
123	24 June 2016	SEBI releases Consultation Paper on amendments to the PMS Regulations	
124	24 June 2016	GAAR - grandfathering of investments made prior to 1 April 2017	
125	24 June 2016	Decoding the draft Model GST law - Impact on the IT/ ITES sector	
126	24 June 2016	Decoding the draft Model GST law - Impact on the Financial Services sector	
127	24 June 2016	CBEC issues exemption notifications under Krishi Kalyan Cess and service tax	Notification Nos. 35-36/ 2016 - service tax, dated 23 June, 2016
128	27 June 2016	Decoding the draft Model GST law - Key features of the draft Model GST Law	
129	27 June 2016	CBDT clarifies applicability of amended TCS provisions on sale of goods and services	Circular No. 23/ 2016 dated 24 June 2016
130	28 June 2016	Decoding the draft Model GST law - Impact on Telecom Companies	
131	28 June 2016	CBDT notifies conditions for non-resident deductees to avail relaxation from higher withholding tax rule in absence of PAN	
132	29 June 2016	Decoding the draft Model GST law - Impact on Infrastructure sector	
133	29 June 2016	Income Declaration Scheme 2016: CBDT issues second set of FAQs to provide more clarification	Circular No. 24 of 2016 dated 27 June 2016
134	30 June 2016	CBDT notifies FTC Rules allowing resident taxpayers to claim credit for taxes paid overseas	Notification No. 54/ 2016 dated 27 June 2016

Sn	Date	Issue	Ruling/ Notification/ Circular
135	01 July 2016	Income Declaration Scheme 2016: Third set of FAQs released by CBDT resolving further queries received from general public	Circular No. 25/ 2016 dated 30 June 2016
136	01 July 2016	Computation of Income attributable to Indirect Transfer of Assets and reporting thereon	Notification No. S.O. 2226(E) dated 28 June 2016
137	01 July 2016	India and Cyprus renegotiate double taxation avoidance agreement	Notification dated 1 July 2016
138	03 July 2016	MCA issues Companies (Acceptance of Deposits) Amendment Rules, 2016	
139	07 July 2016	CBDT defers Income Computation and Disclosure Standards to AY 2017-18	
140	08 July 2016	Mumbai Tribunal rules that supply of off-the-shelf software not taxable as royalty	TS-351-ITAT-2016 (Mumbai-Tribunal)
141	08 July 2016	Transponder charges are taxable in India if equipment is maintained in India for testing signal	TS-365-ITAT-2016 (Chennai-Tribunal)
142	08 July 2016	Karnataka HC: Excise duty included in unsold finished goods paid before due date for furnishing tax return held allowable u/ s 43B of Income-tax Act	ITA No. 836/ 2009 (Karnataka)
143	12 July 2016	SEBI releases consultation paper on disclosures to be made by InvITs in offer documents/ placement memoranda and valuation reports	
144	13 July 2016	Decoding the draft Model GST law - Impact on Entertainment and Media sector	
145	13 July 2016	Hard to value intangibles – transfer pricing perspectives from recent Tribunal ruling	
145	15 July 2016	Income Declaration Scheme, 2016 - CBDT revises time schedule for making payment and issues further clarifications	Circular No. 25/ 2016 dated 30 June 2016
147	15 July 2016	Upholding levy of penalty, Tribunal rejects ‘No loss carry-back’ proposition to justify incorrect MAT working	
148	20 July 2016	Actual letting out of property during year not necessary for claiming vacancy allowance while computing “income from house property”	ITA No. 747/ PN/ 2014

Sn	Date	Issue	Ruling/ Notification/ Circular
149	20 July 2016	Tribunal Special Bench rules on principle of ‘base erosion’	ITA Nos. 1548 & 1549/ Kol/ 2009, TS-467-ITAT-2016 (Kolkata-Tribunal), AYs 2003-04 & 2004-05, ITAT Kolkata - Special Bench
150	25 July 2016	Social Security Agreement between India and Japan to be made effective from 1 October 2016	India-Japan Social Security Agreement, dated 20 July 2016
151	26 July 2016	Draft rules for amount received on buy back of shares released	F No. 370133/ 30/ 2016-TPL dated 25 July 2016
152	28 July 2016	Delhi High Court: Income arising to non-resident from transfer of intangible property to another non-resident not taxable in India	WP[C] 6902/ 2008
153	28 July 2016	Goodwill created on converting sole proprietary concern to company not exempt under section 47(xiv) of Income-tax Act in proprietor’s hands	ITA No. 1731 of 2014
154	28 July 2016	Union cabinet approves amendments to GST constitution amendment bill	
155	29 July 2016	Berry Ratio upheld by Delhi High Court	ITA No. 381/ 2013, ITA No. 738/ 2015, ITA No. 382/ 2013, ITA No. 702/ 2014; [2016] 71 taxmann.com 290 (Delhi)
156	02 August 2016	Consideration for sale of rights in trademarks to be split between primary trademark and associate trademark while computing capital gains	ITA No. 1706/ Ahmedabad/ 2009
157	02 August 2016	SEBI releases discussion paper on review of framework for Institutional Trading Platform	
158	02 August 2016	RBI releases Guidelines for ‘on tap’ Licensing of Universal Banks in the Private Sector	
159	02 August 2016	CBEC removes customs bonding requirement for EOUs	
160	03 August 2016	Rajya Sabha passes GST Constitution Amendment Bill	
161	03 August 2016	Protocol is an integral part of the tax treaty –need not be separately notified; Restrictive definition of India-UK tax treaty can be read into India-France tax treaty	W.P. (C) 4793/ 2014& CM APPL. 9551/ 2014

Sn	Date	Issue	Ruling/ Notification/ Circular
162	04 August 2016	Export commission paid to non-resident abroad not taxable under section 9(1)(i) of Income-tax Act	TS-417-ITAT-2016 (Ahmedabad-Tribunal)
163	04 August 2016	Delhi Tribunal denies Tax Officer's assumption of power to make arm's length price adjustment in garb of disallowance under section 37(1)	TS-496-ITAT-2016 (Delhi-Tribunal)
164	09 August 2016	Indian securities market regulator releases discussion paper on algorithmic trading and co-location	http:/ / www.sebi.gov.in/ cms/ sebi_data/ attachdocs/ 1470393485587.pdf
165	10 August 2016	Additional recommendations from Committee examining framework for computing book profit for purpose of MAT levy for Ind AS compliant companies in year of adoption and thereafter	
166	10 August 2016	Share premium received held not liable to tax under Income-tax Act	TS-430-ITAT-2016 (Mumbai-Tribunal)
167	11 August 2016	Amendment in regulations for foreign investment in NBFCs	
168	16 August 2016	SC reaffirms that income from letting out properties should be treated as "profits and gains of business or profession" and not as "income from house property"	TS-437-SC-2016 (SC)
169	17 August 2016	Indian distributor of non-resident channel company not a PE; revenue from distribution of channels in India not taxable as royalty	[2016] 72 taxmann.com 143 (Mumbai)
170	18 August 2016	Share allotted in IPOs are not "purchased" within Explanation to section 73; gain/ loss on sale of such shares cannot be deemed to be speculative business thereunder	TS-440-HC-2016 (Gujarat)
171	18 August 2016	Service tax on freight forwarders on transportation of goods	Circular No. 197/ 7/ 2016
172	19 August 2016	Stringent action upheld for non-filing of e-TDS returns even where tax deducted and deposited in time	TS-445-HC-2016 (Allahabad)
173	19 August 2016	Services of individual software developer taxable as independent personnel services, and not as FIS under India-USA tax treaty	TS-438-ITAT-2016 (Ahmedabad-Tribunal)

Sn	Date	Issue	Ruling/ Notification/ Circular
174	21 August 2016	Income Declaration Scheme, 2016 - CBDT amends the Rules and issues fifth set of FAQs	
175	24 August 2016	Royalty income of non-residents, not being effectively connected with PE in India, is taxable on gross basis	ITA Nos. 5447/ Delhi/ 2010 & 5696/ Delhi/ 2012
176	26 August 2016	Payments made to non-residents for AMC services not FTS under both, the Act and the tax treaty, since these services were in the nature of routine repairs and maintenance	TS-456-ITAT-2016 (Delhi-Tribunal)
177	01 September 2016	Transfer of Indian branch in foreign company amalgamation held not liable to tax in India as section 47(vi) benefit allowed to foreign company applying non-discrimination clause in tax treaty	AAR No. 1130 of 2011 [TS-468-AAR-2016 (AAR)]
178	02 September 2016	Scheme for grant of Permanent Residency Status to foreign investors	Scheme for grant of Permanent Residency Status to foreign investors
179	07 September 2016	Call option right on shares for an ‘incredibly long period’, is a valuable right and a separate class of asset distinct from the shares	[2016] 73 taxmann.com 14 (Mumbai-Tribunal)
180	09 September 2016	For spv controlled and managed in mauritius, capital gains on sale of shares in indian company held to be taxable in mauritius	AAR No. 991 of 2010
181	09 September 2016	Income-tax return filing due date extended from 30 september 2016 to 17 october 2016	
182	13 September 2016	Offshore supplies held on facts to be taxable in india in case of composite contract for supplies and services; supply transaction not completed outside india	AAR No. 981 of 2010
183	09 September 2016	President of India gives assent to the Constitution Amendment Bill for GST (GST Bill)	
184	19 September 2016	CBDT issues clarifications on Direct Tax Dispute Resolution Scheme	Circular No. 33/ 2016 dated 12 September 2016
185	22 September 2016	Tribunal upholds disallowance of expenditure on doctors’ overseas travel incurred by pharma company–provides directions on deductibility of cost of free samples given to doctors	

Sn	Date	Issue	Ruling/ Notification/ Circular
186	22 September 2016	No disallowance under section 14A on basis of presumption that non-interest bearing funds were utilised for making investments	TS-498-HC-2016 (Punjab & Haryana)
187	27 September 2016	Government issues draft rules for registration, invoicing, payment, refunds and returns under GST	
188	27 September 2016	Programme fees received by non-profit US university for education programmes in India not taxable as FIS or as business income	TS-490-AAR-2016 (AAR)
189	27 September 2016	Share capital issued with attached occupancy rights was capital receipt–ought not to have been treated as business income	Civil Appeal No(s). 7379-7380-SC-2016 (SLP No (s). 7857-7858 of 2012)
190	28 September 2016	“Intent of letting” not enough to claim vacancy rent allowance while computing income under the head “income from house property”	ITA No. 6717/ Mumbai/ 2012
191	28 September 2016	APA signings in India cross the ‘100-mark’	
192	05 October 2016	CBDT re-notifies Income Computation and Disclosure Standards effective from AY 2017-18 onwards	
193	05 October 2016	Section 54E exemption available in relation to gain arising on sale of “long-term” depreciable asset	TS-532-SC-2016 (SC)
194	06 October 2016	Maintenance charges received in relation to the property should be regarded as “rent” for computing income taxable under the head “income from house property”	ITA No. 369 of 2015
195	07 October 2016	Commission payments by taxpayer not allowed as an expense as payee was not produced	TS-542-ITAT-2016 (Hyderabad-Tribunal)
196	10 October 2016	Tribunal acknowledges need to conduct credit rating and comparables search in a scientific and logical manner; deletes TP addition on guarantee being in nature of a shareholder activity based on facts	ITA No. 1912/ Kolkata/ 2012

Sn	Date	Issue	Ruling/ Notification/ Circular
197	17 October 2016	Amendment introduced to remove undue hardship to taxpayer or to remove an apparent incongruity ought to be treated as retrospective	ITA No. 1237/ Ahmedabad/ 2013
198	18 October 2016	CBDT clarifies that no tax is required to be deducted at source under section 194-I of the Income-tax Act, 1961, on lease premium paid for acquisition of long-term leasehold rights	CBDT Circular No. 35 of 2016 dated 13 October 2016
199	18 October 2016	Allocation of part of consideration for transfer of shares towards non-compete fee held not justified	ITA No. 3963 / Mumbai/ 2011
200	19 October 2016	Development agreement without passing of possession does not result in transfer liable to capital gains tax	TS-551-ITAT-2016 (Mumbai-Tribunal)
201	20 October 2016	Final rules for determining amount received by the company on issue of shares, being subject matter of buy back, notified	Notification No. 94/ 2016 [F.No. 370133/ 30/ 2016-TPL/ GSR 982(E) dated 17 October 2016
202	28 October 2016	Revised tax treaty signed between India and South Korea	Press Release dated 26 October 2016 issued by the Government of India
203	02 November 2016	Supreme Court upheld tax on capital-gains, on transfer of interest in partnership asset, in the hands of the partner	Civil Appeal No. 1234 of 2012
204	03 November 2016	Section 45(3) is not applicable to stock-in-trade contributed by a partner in a partnership firm	[2016] 74 taxmann.com 187 (Kolkata)
205	04 November 2016	Separate purchase of brand followed by merger of the seller company with the purchaser held not to be a colourable devise and depreciation on brand allowed	TS-573-ITAT-2016 (Chennai-Tribunal)
206	06 November 2016	Government of India excludes Nepalese and Bhutanese nationals from the special category of International Worker	G.S.R.1035(E) dated 2 November 2016
207	08 November 2016	GSTN launches portal for migration of existing registrations	

Sn	Date	Issue	Ruling/ Notification/ Circular
208	08 November 2016	Tribunal holds Indian subsidiary to constitute a fixed PE as well as an agency PE of the foreign parent company	ITA No. 1742/ Mds.2011
209	09 November 2016	Election results may provide opportunities for major tax law changes in 2017	
210	11 November 2016	Change in service tax treatment (B2B and B2C) of Online Information/ Cloud Services	Circular No. 202/ 12/ 2016-Service Tax dated 9 November 2016 Notification Nos. 46/ 2016-ST, 47/ 2016-ST, 48/ 2016-ST and 49/ 2016-ST dated 9 November 2016
211	17 November 2016	Supreme Court sets aside Bombay High Court judgement that “colourable device” had aided debenture transaction	LSI-1289-SC-2016-(NDEL)
212	18 November 2016	Double taxation avoidance agreement between India and Cyprus revised	
213	21 November 2016	Capital gains not chargeable on transfer of undertaking without consideration by a wholly-owned subsidiary to its holding company under a scheme of arrangement	TS-608-ITAT-2016(Mumbai-Tribunal)
214	21 November 2016	Amendment in provisions relating to inoperative accounts	
215	22 November 2016	Restrictive definition of FTS in India-Portugal treaty does not automatically apply to India-Switzerland tax treaty by virtue of MFN clause	ITA No. 624/ Ahd/ 2012 [TS-609-ITAT-2016(Ahmedabad-Tribunal)
216	25 November 2016	Non-compete right held to be an intangible asset eligible for depreciation	ITA No. 1185 & 1186 (Bangalore-Tribunal) 2016
217	25 November 2016	Tribunal upheld application of Explanation 3 to section 43(1) in case of improper allocation of purchase consideration	TS-620-ITAT-2016(Bangalore-Tribunal)
218	26 November 2016	Revised version of Draft Model GST Law issued	
219	29 November 2016	Indian government proposes to introduce new income disclosure scheme post-demonetisation by paying 50% of income disclosed thereunder, and amending existing provisions to eliminate loopholes	

Indirect Taxes Newsletters

Sn	Issue
1	PwC Newsletter: Indirect Taxes - December 2015
2	PwC Newsletter: Indirect Taxes - January 2016
3	PwC Newsletter: Indirect Taxes - February 2016
4	PwC Newsletter: Indirect Taxes - March 2016
5	PwC Newsletter: Indirect Taxes - April 2016
6	PwC Newsletter: Indirect Taxes - May 2016
7	PwC Newsletter: Indirect Taxes - June 2016
8	PwC Newsletter: Indirect Taxes - July 2016

Customs, FTP and WTO Newsletters

Sn	Issue
1	PwC Newsletter: Customs, FTP and WTO - December 2015
2	PwC Newsletter: Customs, FTP and WTO - January 2016
3	PwC Newsletter: Customs, FTP and WTO - February 2016
4	PwC Newsletter: Customs, FTP and WTO - March 2016
5	PwC Newsletter: Customs, FTP and WTO - April 2016
6	PwC Newsletter: Customs, FTP and WTO - May 2016
7	PwC Newsletter: Customs, FTP and WTO - June 2016
8	PwC Newsletter: Customs, FTP and WTO - July 2016

Tax Treaties entered into by India

Sr No	Country	Notification No. and Date	Date when signed	Date of coming into force
1	Albania	Notification No. 2/ 2014 [F. No. 501/ 1/ 2003-FTD-I]/ SO 47(E), dated 7-1-2014	08 July 2013	04 December 2013
2	Armenia	Notification No. GSR 800E, dated 8-12-2004	31 October 2003	09 September 2004
3	Australia	Notification No. GSR 60(E), dated 22-1-1992	25 July 1991	20 December 1991
4	Austria	Notification No. GSR 682(E), dated 20-9-2001	08 November 1999	05 September 2001
5	Azerbaijan		20 November 1988	01 April 1990
6	Bangladesh	Notification No. GSR 758(E), dated 8- 9-1992	27 August 1991	27 May 1992
7	Belarus	Notification No. GSR 392(E), dated 17-7-1998	27 September 1997	17 July 1998
8	Belgium	Notification No. GSR 632(E), dated 31-10-1997, as amended by Notification No. SO 54(E), dated 19-1-2001. Earlier agreement was entered into vide GSR 323(E), dated 6-6-1975 which was later amended by GSR 321(E), dated 2-3-1988.	26 April 1993	01 October 1997
9	Bhutan	Notification No. 42/ 2014 [F.NO.503/ 4/ 2004-FTD-II], dated 5-9-2014	04 March 2013	17 July 2014
10	Botswana	Notification No. 70/ 2008-FTD, dated 18-6-2008	08 December 2006	31 January 2008
11	Brazil	Notification No. GSR 381(E), dated 31-3-1992	26 April 1988	11 March 1992
12	Bulgaria	Notification No. GSR 205(E), dated 9-5-1996	26 May 1994	23 June 1995
13	Canada	Notification No. SO 28(E), dated 15-1-1998. Earlier agreement was entered into vide GSR 1108(E), dated 25-9-1986, as amended by GSR 635(E) dated 24-6-1992. Circular No. 638, dated 28-10-1992 dealt with this agreement.	11 January 1996	06 May 1997
14	China (People's Republic of China)	Notification No. GSR 331(E), dated 5-4-1995	18 July 1994	21 November 1994

Sr No	Country	Notification No. and Date	Date when signed	Date of coming into force
15	Croatia	Notification No.24/ 2015 [F.NO.501/ 09/ 1995-FTD-I], dated 17-3-2015	12 February 2014	Not yet in force.
16	Chinese Taipei (Taiwan)		12 July 2011	12 August 2011
17	Colombia	Notification No.44/ 2014 [F.NO.501/ 3/ 99-FTD-II], dated 23-9-2014	13 May 2011	07 July 2014
18	Cyprus	Notification No. GSR 805(E), dated 26-12-1995	13 June 1994	21 December 1994
19	Czech Republic	Notification No. GSR 811(E), dated 8-12-1999	01 October 1998	27 September 1999
20	Denmark	Notification No. GSR 853(E), dated 25-9-1989	08 March 1989	13 June 1989
21	Egypt (United Arab Re-public)	Notification No. GSR 2363, dated 30-9-1969	20 February 1969	30 September 1969
22	Estonia	Notification No. 27/ 2012 [F.NO.503/ 02/ 1997- FTD-1]/ SO NO. 1677(E), dated 25-7-2012	19 September 2011	20 June 2012
23	Ethiopia	Notification No. 14/ 2013 [FT & TR-II/ F. No. 503/ 01/ 1996-FT&TR-II], dated 21-02-2013	25 May 2011	01 April 2013
24	Fiji	Notification No.35/ 2014 [F.NO.503/ 11/ 2005-FTD-II], dated 12-8-2014	30 January 2014	15 May 2014
25	Finland	Notification No. 36/ 2010 [F. NO. 501/ 13/ 1980-FTD-I], dated 20-5-2010	15 January 2010	19 April 2010
26	France	Notification No. 9602 [F. No. 501/ 16/ 80-FTD], dated 6-9-1994, as amended by Notification No. SO 650(E), dated 10-7-2000	29 September 1992	01 August 1994
27	Georgia	Notification No. 4/ 2012[F.NO.503/ 05/ 2006-FTD.I], dated 6-1-2012	24 August 2011	08 December 2011
28	Germany	Notification No. SO 836(E), dated 29-11-1996. Earlier an agreement was entered with Federal German Republic vide GSR 1090, dated 13-9-1960 and vide GSR 107(E), dated 2-3-1990 and agreement was entered with German Democratic Republic.	19 June 1995	26 October 1996
29	Greece	Notification No. GSR 394, dated 17-3-1967	11 February 1965	17 March 1967

Sr No	Country	Notification No. and Date	Date when signed	Date of coming into force
30	Hungary	Notification No. GSR 197(E), dated 31-3-2005	03 November 2003	04 March 2005
31	Iceland	Notification No. S.O. 241(E), dated 5-2-2008	23 November 2007	21 December 2007
32	Indonesia	Notification No. S.O. 1144(E) [NO.17/ 2016 (F.NO.503/ 4/ 2005-FTD-II)], dated 16-3-2016	27 July 2012	05 February 2016
33	Ireland	Notification No. 45/ 2002 [F. No. 503/ 6/ 99-FTD], dated 20-2-2002	06 November 2000	26 December 2001
34	Israel	Notification No. GSR 256(E), dated 26-6-1996	29 January 1996	15 May 1996
35	Italy	Notification No. GSR 189(E), dated 25-4-1996. Earlier agreement was entered into vide GSR 608(E), dated 8-4-1986	19 February 1993	23 November 1995
36	Japan	Notification No. GSR 101(E), dated 1-3-1990, as amended by Notification Nos. SO 753(E), dated 16-8-2000 (w.r.e.f. 1-10-1999), SO 1136(E), dated 19-7-2006, w.r.e.f. 28-6-2006 and SO 2528(E), dated 8-10-2008, w.e.f. 1-10-2008	07 March 1989	29 December 1989
37	Jordan	Notification No. GSR 810(E), dated 8-12-1999	20 April 1999	16 October 1999
38	Kazakhstan	Notification No. GSR 633(E), dated 31-10-1997	09 December 1996	02 October 1997
39	Kenya	Notification No. GSR 665(E), dated 20-8-1985	12 April 1985	20 August 1985
40	Korea, (Republic of)		18 May 2015	12 September 2016
41	Kuwait	Notification No. SO 2000(E), dated 27-11-2007	15 June 2006	17 October 2007
42	Kyrgyz Republic	Notification No. GSR 75(E), dated 7-2-2001	13 April 1999	10 January 2001
43	Latvia	Notification No.12/ 2014 [F.NO.503/ 02/ 1997-FTD-I], dated 5-3-2014	18 September 2013	01 April 2014
44	Libya	Notification No. GSR 22(E), dated 1-7-1982	02 March 1981	01 July 1982
45	Lithuania	Notification No. 28/ 2012 [F. No. 503/ 02/ 1997-FTD-1], dated 25-7-2012	26 July 2011	10 July 2012

Sr No	Country	Notification No. and Date	Date when signed	Date of coming into force
46	Luxembourg	Notification No. 78/ 2009 [F. No. 503/ 1/ 96-FTD-I], dated 12-10-2009	02 June 2008	09 July 2009
47	Macedonia	Notification No. 94/ 2015 [F.NO.503/ 08/ 2004-FTD-I] / SO 3499(E), dated 21-12-2015	17 December 2013	12 September 2014
48	Malaysia	Notification No. 07/ 2013 [F. No. 506/ 123/ 84-FTD-II], dated 29-1-2013	29 Jauary 2013	01 April 2013
49	Malta	Notification No. 34/ 2014 [F. No. 504/ 06/ 2003-FTD-I], dated 5-8-2014	05 August 2014	01 April 2015
50	Mauritius	Notification GSR No. 920(E), dated 6-12-1983	24 August 1982	06 December 1983
51	Mexico	Notification No. 86/ 2010 [F. No. 503/ 4/ 91-FTD-I], dated 26-11-2010	10 September 2007	01 February 2010
52	Mongolia	Notification No. SO 635(E), dated 16-9-1996	22 February 1994	29 March 1996
53	Montenegro	Notification No. 4/ 2009 [F.NO. 503/ 1/ 1997-FTD-I]/ S.O. 96(E), dated 7-1-2009	08 February 2006	23 September 2008
54	Morocco	Notification No. GSR 245(E), dated 15-3-2000	30 October 1998	20 February 2000
55	Mozambique	Notification No. 30/ 2011-FT&TR-II [F.NO.501/ 152/ 2000-FT&TR-II], dated 31-5-2011	30 September 2010	28 February 2011
56	Myanmar	Notification No. 49/ 2009-FT & TR-II [F. NO. 504/ 10/ 2004-FT & TR-II], dated 18-6-2009	02 April 2008	30 January 2009
57	Namibia	Notification No. GSR 196(E), dated 8-3-1999	15 February 1997	22 January 1999
58	Nepal	Notification No. 20/ 2012 [F.NO.503/ 03/ 2005-FTD-II], dated 12-6-2012	27 November 2011	16 March 2012
59	Netherlands	Notification No. GSR 382(E), dated 27-3-1989 as amended by Notification No. SO 693(E), dated 30-8-1999 and Notification No. 2/ 2013, dated 14-1-2013	30 July 1988	21 January 1989
60	New Zealand	Notification No. GSR 314(E), dated 27-3-1987, as amended by GSR 477(E), dated 21-4-1988 and GSR 37(E), dated 12-1-2000	17 October 1986	23 December 1986
61	Norway	Notification No. 24/ 2012 [F.NO. 505/ 3A/ 81-FTD-I], dated 19-6-2012	02 February 2011	20 December 2011

Sr No	Country	Notification No. and Date	Date when signed	Date of coming into force
62	OECD Member Countries	Notification No. 35/ 2012 [F. No. 500/ 154/ 2009-FTD-I], dated 29-8-2012	26 Januray 2012	01 June 2012
63	Oman	Notification No. SO 563(E), dated 23-9-1997	02 April 1997	03 June 1997
64	Philippines	Notification No. GSR 173(E), dated 2-4-1996 and as amended by Notification No. SO 125(E), dated 2-2-2005	12 February 1990	21 March 1994
65	Poland	Notification No. GSR 72(E), dated 12-2-1990	21 June 1989	26 October 1989
66	Portuguese Republic	Notification No. GSR 542(E), dated 16-6-2000, as corrected by Notification No. SO 673(E), dated 25-8-2000 and GSR 597(E), dated 20-9-2005	11 September 1998	30 April 2000
67	Qatar	Notification No. GSR 96(E), dated 8-2-2000	07 April 1999	15 January 2000
68	Romania	Notification No. GSR 80(E), dated 8-2-1988	08 March 2013	16 December 2013
69	Russian Federation	Notification No. 10677 [F. No. 501/ 6/ 92-FTD], dated 21-8-1998. Earlier agreement was entered into vide GSR 812(E), dated 4-9-1989, as amended by GSR 952(E), dated 30-12-1992.	25 March 1997	11 April 1998
70	Saudi Arabia	Notification No. 287/ 2006-FTD [F.No. 501/ 7/ 91-FTD], dated 17-10-2006	25 January 2006	01 November 2006
71	Serbia and Montenegro	Notification No. 5/ 2009 [F.No. 503/ 1/ 797-FTD-1]/ S.O. 97(E), dated 7-1-2009	08 February 2006	23 September 2008
72	Singapore	Notification No. GSR 610(E), dated 8-8-1994 as amended by Notification SO 1022(E), dated 18-7-2005	24 January 1994	27 May 1994
73	Slovenia	Notification No. GSR 344(E), dated 31-5-2005	13 January 2003	17 February 2005
74	South Africa	Notification No. GSR 198(E), dated 21-4-1998	04 December 1996	28 November 1997
75	Spain	Notification No. GSR 356(E), dated 21-4-1995	08 February 1993	12 January 1995
76	Sri Lanka	Notification No. 23/ 2014 [F.NO.503/ 8/ 2005-FTD-II]/ SO 956(E), dated 28-3-2014	22 January 2014	01 April 2014

Sr No	Country	Notification No. and Date	Date when signed	Date of coming into force
77	Sudan	Notification No. GSR 723(E), dated 1-11-2004	22 October 2003	15 April 2004
78	Sweden	Notification No. GSR 705(E), dated 17-12-1997. Earlier agreement was entered into vide GSR 38(E), dated 27-3-1989.	24 June 1997	25 December 1997
79	Switzerland	Notification No. GSR 357(E), dated 21-4-1995, as amended by Notification No. GSR 74(E), dated 7-2-2001, 62/ 2011, dated 27-12-2011 w.e.f. 1-4-2012	02 November 1994	29 December 1994
80	Syria	Notification No. 33/ 2009-FTD-II [F.NO. 503/ 7/ 2005-FTD-II], dated 30-3-2009	06 Februray 1984	25 June 1985
81	Tajikistan	Notification No. 58/ 2009 [FT & TR-II [F.No. 503/ 10/ 95-FT & TR-II], dated 16-7-2009	20 November 2008	10 April 2009
82	Tanzania	Notification No. 8/ 2012 [FT & TR-II/ F. No. 503/ 02/ 2005-FTD-II], dated 16-2-2012	27 May 2011	12 December 2011
83	Thailand	Notification No.88/ 2015 [F.No.503/ 5/ 2005-FTD-II], dated 1-12-2015	29 June 2015	13 October 2015
84	Trinidad & Tobago	Notification No. GSR 720(E), dated 26-10-1999	08 February 1999	13 October 1999
85	Turkey	Notification No. SO 74(E), dated 3-2-1997	31 January 1995	01 February 1997
86	Turkmenistan	Notification No. GSR 567(E), dated 25-9-1997	25 February 1997	07 July 1997
87	Uganda	Notification No. GSR 666(E), dated 12-10-2004	30 April 2004	27 August 2004
88	Ukraine	Notification : GSR 24(E), dated 11-1-2002	07 April 1999	31 October 2001
89	United Arab Emirates	Notification No. GSR 710(E) [No. 9409 (F. No. 501/ 3/ 89-FTD)], dated 18-11-1993, as amended by Notification No. SO 2001(E), dated 28-11-2007. Earlier agreement was entered into vide GSR 969(E), dated 8-11-1989.	29 April 1992	22 September 1993
90	United Kingdom	Notification No. GSR 91(E), dated 11-2-1994	25 January 1993	26 October 1993
91	United States	Notification No. GSR 990(E), dated 20-12-1990.	12 September 1989	18 December 1990

Sr No	Country	Notification No. and Date	Date when signed	Date of coming into force
92	Uruguay	Notification No. 53/ 2013 [F.NO.500/ 138/ 2002-FTD-II]/ SO 2081(E), dated 5-7-2013	08 September 2011	01 April 2014
93	Uzbekistan	Notification No. SO No. 2689(E), dated 7-11-2012	29 July 1993	25 January 1994
94	Vietnam	Notification No. GSR 369(E), dated 28-4-1995, as amended by Notification No. 9860 [F.No. 503/ 7/ 91-FTD], dated 12-9-1995	07 September 1994	02 February 1995
95	Zambia	Notification: No. GSR 39(E), dated 18-1-1984	05 June 1981	18 January 1984

Tax Information Exchange Agreements (TIEAs)

Sr No	Country	Notification No. and Date	Date when signed	Date of coming into force
1	Argentina	Notification No. 22/ 2013 [F.NO. 504/ 3/ 2010-FTD-II]/ SO 824(E), dated 22 March 2013	21 November 2011	28 January 2013
2	Bahamas	No. 25/ 2011 [F.No. 503/ 6/ 2009-FTD-I]/ SO 1049(E), dated 13 May 2011	11 February 2011	01 March 2011
3	Bahrain	Notification No. 44/ 2013[F.NO.503/ 03/ 1994-FT&TR-II]/ SO 1766(E), dated 19 June 2013	31 May 2012	11 April 2013
4	Belize	Notification No. 3/ 2014[F.NO.503/ 4/ 2012-FTD-I]/ SO 48(E), dated 7 January 2014	18 September 2013	25 November 2013
5	Bermuda	Notification No. 5/ 2011 [F. No. 503/ 2/ 2009-FTD-I], dated 24-1-2011	07 October 2010	03 November 2010
6	British Virgin Islands	Notification No. 54/ 2011 [F.NO. 503/ 10/ 2009-FTD-I] S.O. 2301(E), dated 3 October 2011	09 February 2011	22 August 2011
7	Cayman Islands	Notification No.61/ 2011[F.No.503/ 03/ 2009-FTD-I]/ S.O. 2902(E), dated 27 December 2011	21 March 2011	08 November 2011
8	Gibraltar	Notification No. 28/ 2013 [F.NO.503/ 11/ 2009-FTD-I]/ SO 924(E), dated 1 April 2013	01 February 2013	11 March 2013
9	Guernsey	Notification No. 30/ 2012 [F. No. 503/ 1/ 2009-FTD-I]/ SO 1782(E), dated 9 August 2012	20 December 2011	11 June 2012
10	Isle of Man	Notification No. 26/ 2011 [F.NO. 503/ 01/ 2008 - FTD-I]/ SO 1048(E), dated 13 May 2011	04 February 2011	17 March 2011
11	Jersey	Notification No. 26/ 2012 [F. No. 503/ 6/ 2008-FTD-I]/ SO 1541(E), dated 10 July 2012	03 November 2011	08 May 2012
12	Principality of Liechtenstein	Notification No. 30/ 2014[F.NO.503/ 4/ 2009-FTD-I]	28 March 2013	20 January 2014
13	Liberia	Notification No. 32/ 20012-FT&TR-II [F.No. 503/ 02/ 2010-FT&TR-II]/ SO 1877(E), dated 17 August 2012	03 October 2011	20 March 2012
14	Macau, China	Notification No. 43/ 2012[F.NO.503/ 04/ 2009-FT&TR-II]/ SO 2427(E), dated 10 Otcober 2012	03 January 2012	16 April 2012
	Maldives	Notification No. SO 2865(E) [NO.76/ 2016 (F.NO.500/ 79/ 2008-FTD-II)], dated 2 September 2016	11 April 2016	02 August 2016
15	Monaco	Notification No. 43/ 2013 [F.NO.503/ 05/ 2009-FTD-I]/ SO 924(E), dated 12 June 2013	31 July 2012	27 March 2013
16	San Marino	Notification No. 63/ 2015 [F.No.500/ 02/ 2003-FTD-I], dated 12 August 2015	19 December 2013	29 August 2014
17	St. Kitts and Nevis	Notification No. SO 2488(E) [NO.62/ 2016 (F.NO.503/ 09/ 2009-FTD-I)], dated 21 July 2016	11 November 2014	02 February 2016
18	Seychelles	Notification No. SO 2894(E) [NO.80/ 2016 (F.NO.503/ 07/ 1993-FT&TR-IV)], dated 8 September 2016	26 August 2015	28 June 2016

List of Social Security Agreements

Sr No	Country	Date when signed	Date of coming into force
1	Australia	18 November 2014	01 January 2016
2	Austria	04 February 2013	01 July 2015
3	Belgium	03 November 2006	01 September 2009
4	Czech Repulic	09 June 2010	01 September 2014
5	Canada	06 November 2012	1 Auguat 2015
6	Denmark	17 February 2010	01 May 2011
7	Finland	12 June 2012	01 August 2014
8	French Republic	30 September 2008	01 July 2011
9	Germany (On Social Insurance)	08 October 2008	01 October 2009
10	Hungary	03 February 2010	01 April 2013
11	Korea	19 October 2010	01 November 2011
12	Luxembourg	30 September 2009	01 June 2011
13	Netherlands	22 October 2009	01 December 2011
14	Norway	29 October 2010	1 Januray 2015
15	Swiss Conferderation	03 September 2009	29 January 2011
16	Sweden	26 November 2012	01 August 2014

Signed but not notified:

- Germany (On Social Security) – 12 October 2011
- Japan – 16 November 2012
- Portugal – 4 March 2013
- Quebec – 26 November 2013

Limited Tax Treaties

Sr No	Country	Notification
1	Afghanistan	Notification No. GSR 514(E), dated 30 September 1975
2	Ethiopia	Notification No. GSR 8(E), dated 4-1-1978 as corrected by Notification No. GSR 159(E), dated 2 March 1978
3	Iran	Notification No. GSR 284(E), dated 28 May 1973
4	Lebanon	Notification Nos. GSR 1552 and 1553, dated 28 June 1969
5	Maldives	Notification No. 3/ 2011 [SO 34(E)]-FTD-II [F.NO. 500/ 96/ 97-FTD-II], dated 10 January 2011
6	Pakistan	Notification No. GSR 792(E), dated 29 August 1989
7	People Democratic Republic of Yemen	Notification No. GSR 857(E), dated 12 August 1988
8	Yemen Arab Republic	Notification No. GSR 2(E), dated 1 January 1987

Glossary

AAR	Authority for Advance Ruling
AE	Associated Enterprise
AIF	Alternative Investment Fund
ALP	Arm's Length Price
AIR	Annual Information Return
ALV	Annual letting value
AMP	Advertising, Marketing and Promotion expenses
AMT	Alternate Minimum Tax
APAs	Advance Pricing Arrangements
ARC	Asset reconstruction company
AY	Assessment Year
BEPS	Base Erosion and Profit Shifting
BLT	Bright Line Test
BOT	Build-operate-transfer
B2B	Business to Business
CASS	Computer Assisted Scrutiny Selection
CbCR	Country-by-Country Reporting
CBDT	Central Board of Direct Taxes
C&AG	Comptroller and Auditor General of India
The 2013 Act	Companies Act, 2013
CCPS	Compulsory Convertible Preference Shares
CCDs	Compulsory Convertible Debentures
CIB	Central Information Branch
CLB	Company Law Board
CRS	Common Reporting Standard
CIT(A)	Commissioner of Income-tax (Appeals)
CIT	Commissioner of Income-tax
CUP	Comparable Uncontrolled Price
CENVAT	Central Value Added Tax
CWT(A)	Commissioner of Wealth-tax (Appeals)
ECB	External Commercial Borrowings
EFM	Eligible fund manager
EIF	Eligible investment fund
EVC	Electronic Verification Code
EPFO	Employees Provident Fund Organisation
Rules	Equalisation Levy Rules, 2016
DIPP	Department of Industrial Policy & Promotion

DSE	Designated Stock Exchanges
DRP	Dispute Resolution Panel
Tax treaty	Double Taxation Avoidance Agreement
The Scheme	Direct Tax Dispute Resolution Scheme
The Rules	Direct Tax Dispute Resolution Scheme Rules, 2016
DRP	Dispute Resolution Panel
FATCA	Foreign Account Tax Compliance Act
FAQs	Frequently Asked Questions
FDI	Foreign direct investment
FMV	Fair market value
FAR	Functions performed, Assets employed and Risk assumed
FIS	Fees for Included Services
FIPB	Foreign Investment Promotion Board
FPI	Foreign Portfolio Investment
FSI	Floor Space Index
FS	Financial Statements
FTS	Fees for Technical Services
FTC	Foreign Tax Credit
FY	Financial Year
GAAR	General Anti-Avoidance Rule
GoI	Government of India
HC	High Court
HFT	High Frequency Trading
IPR	Intellectual Property Rights
ISC	Internal Screening Committee
The Act	Income-tax Act, 1961
Tribunal	Income-tax Appellate Tribunal
The Rules	Income-tax Rules, 1962
ICDS	Income Computation and Disclosure Standards
InvIT	Infrastructure Investment Trust
ISD	Input service distributor
IW	International Workers
JDAs	Joint Development Agreements
KYC	Know Your Customer
LLP	Limited Liability Partnership
LMB	Lead Merchant Bankers
LO	Liaison Office
MAP	Mutual Agreement Procedure
MAM	Most Appropriate Method
CbC MCAA	Multilateral Competent Authority Agreement on the exchange of Country-by-Country Reports

MNEs	Multinational Enterprises
MAT	Minimum Alternate Tax
MCA	Ministry of Corporate Affairs
MFN	Most Favoured Nation
MLE	Ministry of Labour & Employment
MoU	Memorandum of Understanding
NAV	Net asset value
NBFC	Non-banking finance company
NCDs	Non-convertible debentures
NCLT	National Company Law Tribunal
NCLAT	National Company Law Appellate Tribunal
NDCFs	Net Distributable Cash Flows
NIIs	Non-Institutional Investors
NJA	Notified Jurisdictional Area
NOFHC	Non-Operative Financial Holding Company
NRI	Non-resident Indian
OPCDs	Optionally Convertible Debentures
OCI	Overseas Citizen of India
OECD	Organisation for Economic Co-opertaion Development
PE	Permanent Establishment
PoEM	Place of Effective Management
PF	Provident Fund
PLI	Profit Level Indicator
POA	Power of Attorney
PRS	Permanent Residency Status
IPOs	Public issues
PSM	Profit Split Method
QIB	Qualified Institutional Buyers
RBI	Reserve Bank of India
REITs	Real Estate Investment Trusts
ROFR	Right of First Refusal
RFPIs	Registered foreign portfolio investors
RPTs	Related Party Transactions
SB	Special Bench
SDT	Specified Domestic Transactions
SEAC	Standing External Advisory Committee
SEBI	Securities and Exchange Board of India
SEZ	Special Economic Zone

SC	Supreme Court
SPV	Special purpose vehicle
SSA	Social security agreement
CESTAT	The Customs, Excise and Service Tax Appellate Tribunal
TCS	Tax collected at source
TDR	Transferable Development Rights
TNMM	Transactional Net Margin Method
TO	Tax Officer
TPO	Transfer Pricing Officer
TP	Transfer pricing
TRC	Tax residency certificate
TOPA	Transfer of Property Act, 1882
WDV	Written Down Value

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