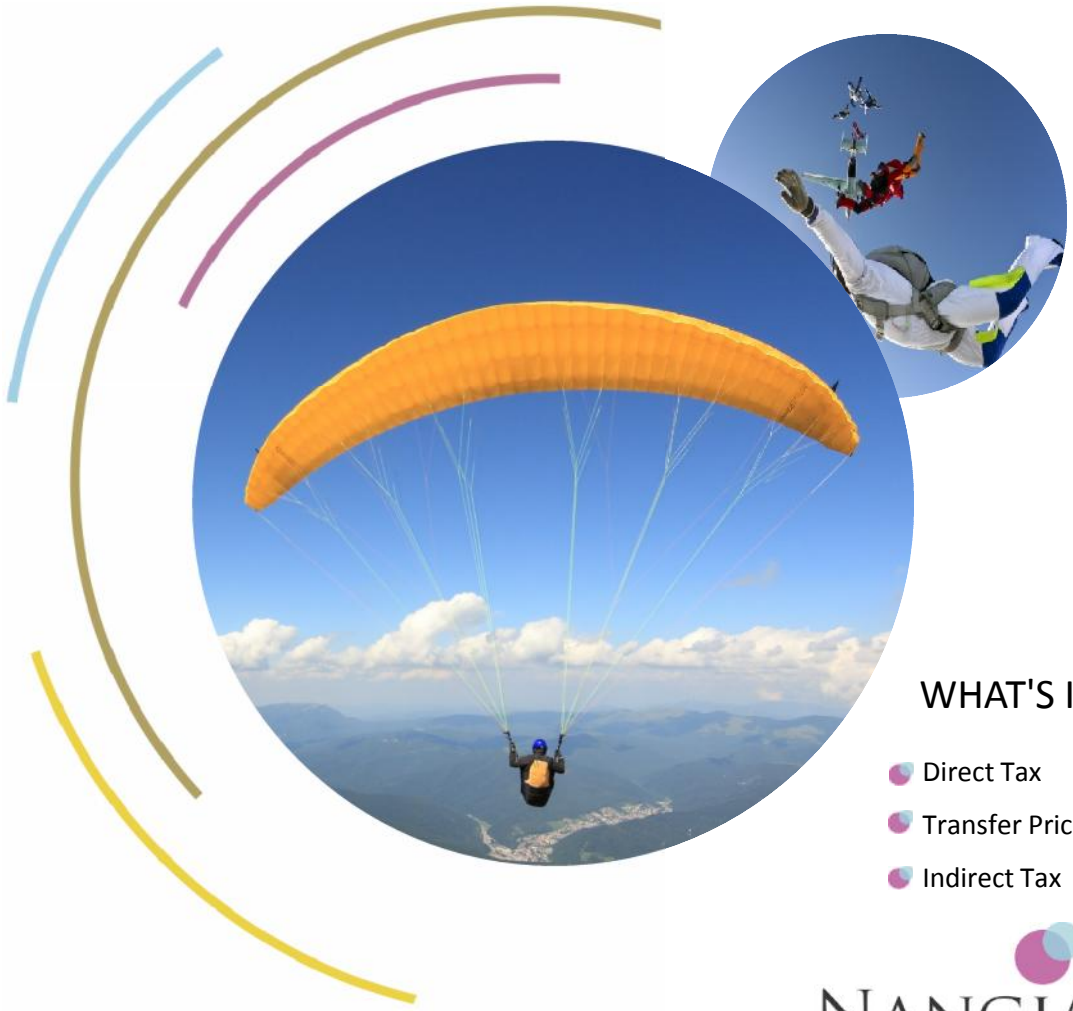
NEWS CRUNCH

July 01-15



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NANGIA & CO
CHARTERED ACCOUNTANTS

What's inside . . .

DIRECT TAX

1. ICDS notified under section 145(2) of the Act to be applicable from FY 2016-17

Vide Notification No. SO 892(E) dated 31 March 2015, the Central Government notified ten Income Computation and Disclosure Standards (ICDS). ICDS were developed with a view to minimizing tax related disputes by bringing greater consistency in the application of accounting principles governing the computation of income.

ICDS was applicable to all Assesses following mercantile system of accounting and chargeable to tax under the head "Profit and Gains of Business or Profession" or "Income from Other Source" from financial year 2015-16.

Subsequent to the notification of ICDS, a number of representations were received recommending amendments to the notified ICDS and also issuance of clarification in respect of certain points raised by the stakeholders. Stakeholders pointed out issues pertaining to complications in implementation of ICDS, unavoidable maintenance of separate books of accounts, deviations from judicial precedents etc. In November 2015, the Central Board of Direct Taxes (CBDT) went into review mode and invited comments/suggestions from stakeholders on ICDS which were to be examined by an Expert Committee.

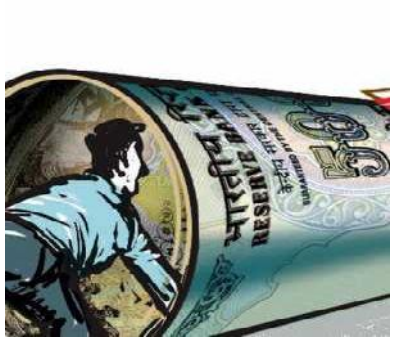
Pending consideration of recommendations made by the said Committee, the Central Government has decided to defer the applicability of ICDS to financial year 2016-17. In the press release issued by the Central Government they have specified that Tax Audit Report is undergoing revision for ensuring compliance with the provisions of ICDS and for capturing the disclosures mandated by ICDS.

Nangia's Take

In the wake of regulatory changes to Companies Act, introduction of Ind AS and GST, an Assessee is already facing a lot of hardships keeping up. Accordingly, the decision to defer ICDS pending clarification is a positive move by the Government and shows Governments willingness to be considerate towards stakeholder concerns.

Source: Press release of Finance Ministry dated July 6, 2017 - ICDS

2. Indirect transfer of assets located in India - Valuation Rules



The Finance Act, 2012, via a retrospective amendment dating back to April 1, 1962, had brought indirect transfers of a capital asset situated in India, within the ambit of Indian tax laws. Indirect transfer means transfer of underlying asset located in a jurisdiction through the transfer of an intermediate holding company located outside jurisdiction.

Certain clarificatory amendments were made to the indirect transfer provision in 2015. Principal amongst these was to provide a threshold for the applicability of the provision. Accordingly, a share or interest is to be deemed to derive value substantially from assets located in India, if –

(a) fair market value ('FMV') of such assets located in India exceeds INR 100 million; and

(b) such FMV of assets located in India represents at least 50 percent of the FMV of total assets of the foreign company or entity whose shares / interest is being transferred

The amendment also referenced that the method for determining the proportion of gains that are to be taxable in India and the manner of determination of FMV of such assets, would be prescribed through specific rules. Central Board of Direct Taxes (CBDT), thereafter issued draft rules and forms in relation with the indirect transfer provisions of the Act on May 23. 2016. As a part of consultative process, the CBDT had invited comments and suggestion from stakeholders and general public by 29 May 2016.

Pursuant to receipt and consideration of the public comments, CBDT has issued notification no. 2226(E) dated June 28, 2016 providing the amendments to the Income tax Rules, 1962 ('Rules') prescribing the manner of determining the FMV of assets (Rule 11UB) and Income attributable to assets in India (Rule 11UC) and information and documents to be furnished under section 285A of the Act (Rule 114DB). The Notification has also prescribed the forms in respect of following:

a) Audit Report under section 9 of the Act (Form 3CT)

b) Report to be filed by the assessee to the Assessing Officer ('AO') furnishing information and documents required under section 285A of the Act (Form 49D)

The requirements given in sub-Rule 3(v) of Rule 114DB makes it necessary to provide to the Indian tax authorities if demanded, the financial and accounting statements of the foreign company or the entity which directly or indirectly holds the assets in India for two years prior to the date of transfer of the share or interest. Similarly, in sub-rule 3(vii), information relating to business operations, personnel, finance and properties and internal and external audit reports of the holding entity / intermediate entity, are required. The rules work on a presumption that an Indian enterprise held by a foreign entity is always in a position to obtain all and any information regarding its holding entity. Entities operating in foreign jurisdiction are expected to be fully cooperative with the Indian entity. On a practical note, this may not be possible as the foreign entity may not be willing to part with its intricate business information to the Indian entity due to confidentiality concerns.

Nangia's Take

Addressing the concern of those foreign entities that have various subsidiaries in India, in order to avoid duplicity of reporting efforts, the rules have been amended to provide that the any one Indian Concern may be designated to provide information and documents on behalf of all the concerns in Form 49D.

It is appreciable that the rules prescribe usage of internationally accepted valuation norms, since simplicity of the valuation rules would ensure lower litigation. However, the Rules do not make it clear whether the Indian tax authorities will be Bound to accept such a valuation method? and Under what circumstances can the Indian tax authorities question the valuation method? and Under what circumstances can the Indian tax authorities reject the valuation method and adopt a new method on their own?

The rules do not take into account a situation where the capital gains arising to the foreign transferor may be exempt from taxes in India under a tax treaty. In such a scenario, while the gains will not be subject to taxation in India by virtue of tax treaties, the Indian concern will have to undergo the entire compliance process nevertheless since it cannot, on its own, take benefit of the tax treaty. The rules should have provided for a situation where compliance may not be deemed necessary where the capital gains of the recipient are exempt from tax under a tax treaty. Also the additional requirement to furnish audit report by the transferor, which was not envisaged in the indirect transfer provisions, is over and above the onerous reporting obligations casted on Indian concerns to maintain and furnish details of overseas transactions which the Indian concerns might not be aware of. Also clarity is needed on the date of applicability of rules, since the indirect transfer provisions are already into force w.e.f. FY 2015-16, which is expected to come in the final text of the rules.

Source: Notification - S.O. 2226 (E) dated 28th June, 2016 – Indirect transfer rules

3. CBDT prescribes rules for claiming Foreign Tax Credit

The CBDT had released draft Foreign Tax Credit (FTC) rules on April 18, 2016 and had invited comments of stakeholders and general public prior to their finalization and notification. There were various issues which had arisen from the draft FTC rules and representations and been made to the Government for various changes to be made.

The CBDT has now finalized and notified the Foreign Tax Credit Rules. While the CBDT has steered away from the more radical changes recommended such as worldwide pooling of credits as opposed to country-by-country and source-by-source credit, it has taken into consideration some very important issues and legislated for them.

The formula prescribed under the Act had led to many uncertainties in claiming credit taxes paid overseas and consequent increase in litigations with the tax department. With a view to provide clarity and reduce litigation, the Central Board of Direct Taxes (CBDT) has inserted Rule 128 with respect to Foreign Tax Credit (FTC), effective from 1 April 2017, to claim credit for taxes, surcharge and cess paid overseas. The said rules provide clarity to the below specific issues/questions:

❖ **Procedure for grant of tax credit in respect of a foreign tax disputed overseas**

The draft rules had mandated that any foreign tax which is disputed by the taxpayer will not be allowed as a credit, however, no provision existed as to what would be done once the dispute was settled. To provide for the procedure for grant of credit in respect of a foreign tax which is disputed in the foreign country, the Rules provide that such disputed foreign tax will be allowed as a credit for the year in which the income is taxed in India, if the taxpayer furnishes evidence of (a) settlement of the dispute; and (b) evidence of payment of the foreign tax. The taxpayer is also required to provide an undertaking that no refund, directly or indirectly will be claimed for this foreign tax. The amendment is a welcome step and taxpayers would now be eligible to claim credit of a foreign tax under dispute once the dispute in the foreign country is finally settled. Interestingly, the credit will be available in the year in which the income is taxed in India. This will involve cash outflow issues for the taxpayer who will have to initially pay tax on the same income twice, once in the foreign country as then again in India.

❖ **Option for self-declaration of documents for grant of foreign tax credit**

The Draft Rules had provided for the furnishing of a certificate from the tax authority of a foreign country for the claim of FTC to be entertained. This was impractical since it would have been a challenge for the taxpayers to get the tax authorities of a foreign country to issue such certificate. Representations had been filed with the CBDT against this proposal given the complexities and difficulties involved. The CBDT has amended this procedure to provide for self-certified documents in lieu of a certificate from the tax authority of a foreign country. The Government has appreciated the concerns of the taxpayers and given an option of providing self-certified documents in addition to furnishing of a certificate from the foreign tax authorities. Under this option, the taxpayer will provide a statement of foreign income and foreign tax paid/deducted in Form 67. Further, a self-certified statement giving the nature of income and the amount of foreign tax deducted / paid can be submitted as long as it is accompanied with the counterfoil / acknowledgement of taxes paid and/or proof of taxes having been deducted at source. This process is much simpler than the complex and difficult procedure involving obtaining a certificate from a foreign tax authority.

❑ ***What is Foreign Tax?***

Foreign tax means

- Where there is an agreement under section 90 for the relief or avoidance of double taxation, tax covered under the said agreement

- In other cases, taxes that are in the nature of income tax as defined in clause (iv) of explanation to section 91 of the Act.

❑ ***What is the amount of credit?***

- FTC is to be computed separately for each source of income arising from a particular country and shall be lower of
- Tax payable under the Act on such income; or
- Tax paid overseas on such income

❑ ***Reporting of foreign tax refunds on account of carry backward of losses***

- A number of foreign countries (for e.g. Australia) provide for carry backward of losses in terms of which allows a company to 'carry-back' tax losses to be offset against tax liabilities in the preceding income years. Using this procedure, taxpayers can claim a tax refund in the foreign country for the earlier years (in which they had paid tax).
- The rules also now provide for reporting of any FTC claimed on account of a foreign tax which is refunded in the succeeding years due to carry backward of losses.

❑ ***In which year shall credit be taken?***

- FTC shall be available in the year in which the corresponding income is offered to tax/assessed India. The Rules also provide for grant of FTC on pro-rata basis where income on which foreign tax is paid, is offered to tax in India in more than one year.

❑ ***Are there any restrictions to availing FTC?***

- FTC shall be available for set off against tax, surcharge and cess under the Act but not against any interest, fee or penalty
- FTC shall be allowed against tax payment under Minimum Alternate Tax (MAT)/Alternate Minimum Tax (AMT) provisions upto the tax payable under normal provisions of the Act
- FTC shall not be available against any amount of foreign tax which is under dispute by the taxpayer

❑ ***What should be the rate of exchange?***

- FTC shall be determined by conversion of currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which tax has been paid or deducted.

❑ ***Are there any prescribed documents?***

- FTC will be allowed on furnishing Form 67 alongwith the documents prescribed therein.

Nangia's Take

It is heartening to see that the Government has adopted a consultative approach in drafting the rules. The rules now eliminate grey areas such as FTC on disputed foreign tax liability and also make it easier for the taxpayer to comply with the documentation requirements. Keeping up with the times, the rules also taken into account carry backward of losses available in foreign countries. All in all, the rules are progressive and provide much needed clarity as well as certainty in claiming FTC.

Source: Notification - S.O. 2213(E) dated 27th June, 2016 – FTC rules

TRANSFER PRICING

4. Where a company is functionally similar and its financial data can reasonably be extrapolated, the same cannot be unheeded on account of having different financial year ending; The High also allowed Section 10A exemption

Facts of the Case

Operating as wholly owned subsidiary of McKinsey Holdings Inc., McKinsey Knowledge Centre India Pvt. Ltd. ["the taxpayer"] is engaged in providing management consulting services. It offers diverse support services in the area of export computer software, IT-enabled services including data processing, customization of data, back office operations and also acts as a support center for providing research analysis and information to various group entities across the globe.

For the assessment year under review, the Revenue filed an appeal before the High Court ["HC"] challenging the deletion of additions made by Assessing Officer ["AO"] on account of disallowing the taxpayer's claim of exemption under Section 10A of Income-tax Act, 1961 ("the Act") along with additions made on account of transfer pricing ["TP"]

Being aggrieved with the order of AO the taxpayer filed an appeal before Commissioner of Income tax (Appeals) ["CIT(A)"] who set aside the both additions made and confirmed by the AO. Revenue, being aggrieved with the same filed an appeal before Income-tax Appellate Tribunal ("ITAT") who also confirmed the findings of CIT(A) and rejected the Revenue's appeal.

Ruling of the HC

- **On disallowing the exemption u/s 10A of the Act**

The HC found merits in the contention of the taxpayer that it is a duly established STP unit which provides of IT-enabled services to the parent company acting as its back office and thereby entitled to the benefit under the expanded definition of the term ***"computer software"***. Its activities are in the nature of data processing, customization of data, acting as the back office of the parent company and acting as support center to its parent company. Based thereon, the HC did not find any dispute in the findings of the lower appellate authorities and held that the taxpayer cannot be deprived from the benefit of Section 10A of the Act.

- **On Rejection of a comparable companies**

  - **Rejection on account of different financial year ("FY") ending:** In this connection, the HC was in agreement with the ITAT findings that if comparable is functionally same as that of tested party (the taxpayer in instant case) then same cannot be rejected merely on the ground that data for entire financial year is not available. If from the available data on record, the results for financial year can reasonably be extrapolated then the comparable cannot be excluded solely on the ground that the comparables have different financial year endings.

- **Elimination on grounds of turnover being less than INR 1 crore:** The HC was in consonance with the ITAT findings with respect to the emphasizing on the functional similarity of the comparable companies. Referring to provisions of Rule 10B of the Income-tax Rules, 1962, the HC opined that every effort must be made in the arm's length price determination to ensure that material effects of differences between the tested party and the comparable must be rejected.

- **Rejection on the basis of undergoing negative growth phase:** The HC observed that the annual report of the rejected comparable company demonstrates a considerable rise in income over the past years.

In the light of aforesaid findings/ reasons, the HC ruled out that the question of law does not arise in the instant case and accordingly the Revenue's appeal stands dismissed.

Nangia's Take

The instant case brings out the fact that the revenue cannot merely reject the comparables for the application of TNMM method for benchmarking international transaction on unreasonable grounds which do not form part of Indian TP legislation. It is clearly provided in the Indian TP legislation that every effort must be made in the ALP determination to ensure that the "material effects of differences" between the tested party and the comparable must be eliminated, provided that the comparables are functionally similar.

Source: Mckinsey Knowledge Centre India Pvt. Ltd. [TS-672-HC-2015(DEL)-TP]

5. Estimation of services rendered and costs for such services may be outside the scope of transfer pricing adjustment

Facts of the Case

- Flakt (India) Limited ("the Taxpayer") is engaged in the business of manufacturing and salw of industrial fans;
- Taxpayer is the subsidiary of Flakt Woods (Luxembourg);
- During AY 2009-10, the Taxpayer paid management service fee to its Associated Enterprise ("AE") and

applied TNMM for benchmarking such payment transaction. During the course of the assessment proceedings for AY 2009-10, the TP Officer ["TPO"] contended that the volume and quality of service were disproportionate to the payment made by the Taxpayer. Thus, TPO rejected the method adopted i.e. TNMM, by the Taxpayer and applied CUP as most appropriate method on the basis that management fee paid by the Taxpayer need to be analyzed item-wise for determination of arm's length price. Relying on the decision of Gemplus India[1], TPO allowed only 25% of the management fees as expenses and thus, made downward adjustment of INR 6.15 crores.

Aggrieved by the findings of the TPO, the Taxpayer approached the Dispute Resolution Panel which allowed the Taxpayer's appeal and set aside the order of TPO. Consequently, the Revenue approached the Tribunal to adjudicate the matter.

[1]**Gemplus India Private Limited vs ACIT [ITA No. 352/Bang/2009]**

ITAT's Adjudication

- ITAT observed that in both TNMM and CUP Method, the comparison has to be made with uncontrolled transaction identified with regard to similar services rendered for the purpose of transfer pricing adjustment.

- ITAT further observed that without identifying the comparable uncontrolled transaction, the TPO simply found that the quality and volume of the services received by the Taxpayer would not commensurate with the payment made by the Taxpayer;

- ITAT noted that TPO failed to conduct an exercise to identify the uncontrolled transaction and identify adjustment which would be necessary with regards to difference between such transactions which could materially affect the price in the open market.

- ITAT, in favour of the Taxpayer, held that in absence of any comparison of the transaction with transaction carried out in an uncontrolled market, this Tribunal is of the considered opinion that the TPO cannot independently come to a conclusion that volume and quality of services was disproportionate to the payment made by the Taxpayer.

Nangia's Take

This judgement provides the much needed clarity on certain fundamental issues revolving around payments made for availing intra-group services – irrelevance of gratuitous services received in the past for determining ALP in current year, appropriateness of use of allocation keys and upholding the right of Taxpayer to determine the need for service. In light of the aggressive approach of Indian Tax department as well as the unfavourable ruling of the Bangalore Tribunal in case of Gemplus India Private Limited, this Chennai Tribunal judgement should be seen as a positive development.

[Source: Flakt (India) Limited; TS-319-ITAT-2016(CHNY)-TP]

INDIRECT TAX

6. CBEC instructs no recovery of confirmed demand during pendency of stay applications

Vide Circular No. 1035/23/2016-CX dated 4 July 2016 ('Circular'), Central Board of Excise and Custom ('CBEC') specifies fresh guidelines on recovery of confirmed demands during pendency of stay applications under Central Excise, Customs and Service Tax. The Circular reviews/ rescinds earlier Circular No. 967/01/2013-CX dated 1 January 2013 and clarifies as follows:

- For the periods prior to 6 August 2014, in cases where stay application is pending before Commissioner (Appeals) or CESTAT, no recovery shall be made during pendency of the stay application;

- For period effective 6 August 2014, Circular No. 984/08/2014-CX dated 16 September 2014, which stated that no coercive measures would be taken during pendency of appeal for recovery of demand in excess of 7.5% or 10% paid as pre-deposit, shall continue to prevail;

- In case demand is confirmed by Hon'ble CESTAT/High Court and stay is pending before Hon'ble High Court/Supreme Court respectively, recovery proceedings may be initiated only after a period of 60 days from the date of order of CESTAT/High Court confirming demand, where no stay is granted by High Court/ Supreme Court respectively against such order.

Nangia's Take

In terms of the Circular No. 967/01/2013-CX dated 1 January 2013, Authorities initiated recovery proceedings against the assessees even in cases where stay applications were pending before Commissioner (Appeals) or CESTAT. However, relief was granted by High Courts against such coercive measures. Subsequently, the Supreme Court dismissed SLP filed by the Department thereby upholding the decision of the High Courts.

In terms of the Circular, fresh guidelines have been issued, much to the relief Assessees, against the coercive measures of recovery specified in Circular dated 1 January 2013.

Source: Circular No. 1035/23/2016-CX dated 4 July 2016]

7. Fresh guidelines on recovery of confirmed demands during pendency of stay applications issued by the Central Board of Excise and Customs ('CBEC')

Vide Circular dated 1 January 2013, the CBEC had issued directions regarding recovery of demands in matters pending before various authorities during the pendency of stay applications. In this regard vide the Circular dated 4 July 2016, CBEC has rescinded Circular dated 1 January 2013 and fresh instructions/ clarifications have been issued in respect of the following:

1. When stay application is pending before Commissioner (Appeals) or Central Excise and Service tax Appellate Tribunal ('CESTAT'):

In light of certain important judgments in the recent past, it has been clarified that in cases where stay application is pending before Commissioner (Appeals) or the CESTAT for periods prior to 6 August 2014, no recovery shall be made during the pendency of the stay application. For subsequent period, instructions contained in Circular dated 16 September 2014 shall continue to be followed. Vide Circular dated 16 September 2014, CBEC had stated that the amount in excess of 7.5% / 10% pre-deposited of the demand made by adjudicating authority, shall not be recovered during pendency of appeal. Circular dated 16 September 2014 further directed that the recovery action, if any, can be initiated only after the disposal of case by Commissioner (Appeal) / CESTAT in favour of the Department. The recovery, in such cases, would include the interest, at the specified rate, from the date duty became payable, till the date of payment.

2. When Demand is confirmed by CESTAT or High Court and stay is pending before High Court or Supreme Court

As a "measure of liberalization" and to ensure "uniformity" in practice, CBEC has directed that recovery proceedings shall be initiated only after a period of 60 days from the date of CESTAT or High Court order confirming the demand, where no stay has been granted by the High Court or Supreme Court respectively against such order. Earlier the Circular dated 1 January 2013 stated that in the above-mentioned case, recovery proceeding could be initiated immediately after the issuance of order of the CESTAT or High Court.

Nangia Take

Circular dated 4 July 2016 brings good news for assesses as it liberalises recovery provisions from assesses where matters are pending litigation.

[Source: Circular no. 1035/23/2016-CX dated 4 July 2016]