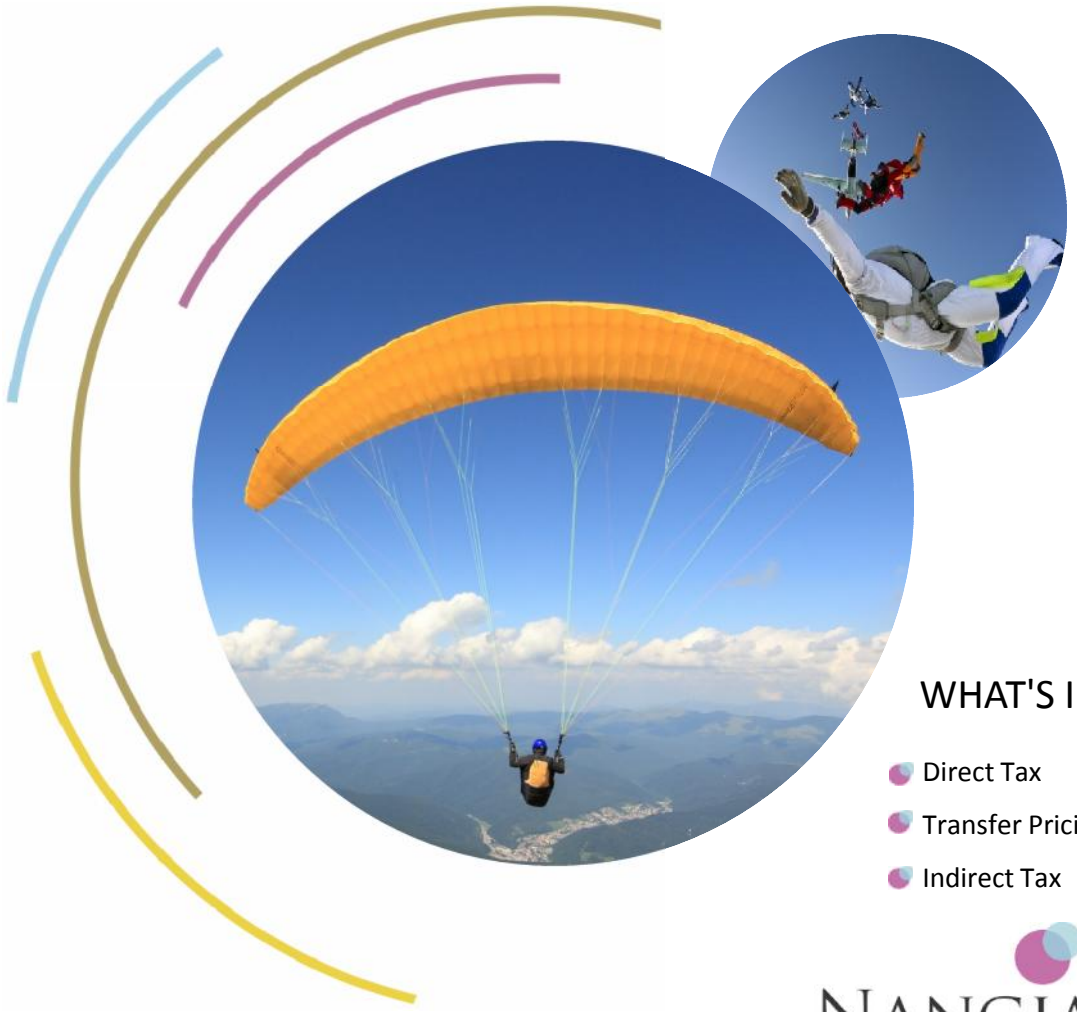
NEWS CRUNCH

December 16 – January 15



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NANGIA & CO
CHARTERED ACCOUNTANTS

What's inside . . .

DIRECT TAX

1. Supreme Court rules on deemed dividend taxation

Supreme Court of India in the recent case of Gopal and Sons (HUF) ("the assessee") ruled on the issue whether advance received by the assessee from Indian Company wherein the assessee's Karta is a registered shareholder can be regarded as deemed dividend under the provisions of the Income-tax Act ("the Act").

The Act provides for deemed dividend taxation in respect of payment by a closely held company by way of advance or loan given to (a) a beneficial shareholder holding not less than 10% of the voting rights in such company; or (b) any concern in which such shareholder (viz. holding 10% or more voting power) is a member or a partner and such shareholder has a substantial interest (20% or more) in the said concern.

The assessee contended that it was neither the beneficial shareholder nor the registered shareholder of the Indian Company as the shares were issued in the name of Karta and, hence, the deemed dividend provisions of the Act are not applicable.

However, Supreme Court held that the deemed dividend provision is attracted in present case as the assessee is a concern in which shareholder (being the Karta) has a substantial interest. Thus, the payment received by the assessee from the Indian company, is deemed dividend under the provisions of the Act.

Supreme Court held that a loan given to a concern can also constitute dividend if a shareholder has substantial interest. It was noted that the Karta in whose name shares were registered has substantial interest in the income of the HUF and that this proposition was not in dispute. It was therefore, concluded that the loan was given to a concern and, hence, the loan can be considered as deemed dividend.

Nangia's Take

Though Supreme Court concluded against the assessee on the basis that the Karta has substantial interest in the HUF by observing that this position is not in dispute, an interesting issue may arise where Karta or member of HUF has inchoate interest in HUF during its subsistence and such interest may not qualify as substantial interest equivalent to 20% or more.

Source: [TS-1-SC-2017]

2. Supreme Court settles certain controversies on profit-linked deduction for export units

Supreme Court in a batch of cases, one of them being the case of Yokogawa India Ltd.[1] ("the assessee") dealt with the issue whether Section 10A of the Act, which provides for profit-linked incentive to an exporter of software and other goods, is an exemption provision or a deduction provision.

Furthermore, the Supreme Court was also required to adjudicate as to whether relief under Section 10A of the Act, admissible in respect of an eligible unit, is to be allowed with respect to profits of an eligible unit before or after set off of losses of other units.

The Supreme Court, after considering the amendment in 2001, held that, post the amendment Section 10A of the Act is a deduction provision, even though its placement in the Act is along with other exemption provisions. It was further held that the deduction under Section 10A of the Act is attached to the eligible unit and is to be computed on a standalone basis, without reference to other eligible or non-eligible units of the assessee. It was also held that the deduction is to be availed of at the stage of computing the income of the eligible unit and not at the stage of computation of the Total Income of the assessee.

Nangia's Take

The issue of whether Section 10A of the Act is a deduction or exemption provision and whether, in computing deduction under Section 10A of the Act, set off of business loss or depreciation of other eligible or non-eligible units is to be considered, had engaged the attention of Indian Courts for quite some time. The present ruling puts at rest various controversies and Circular No. 7, which provides for a contrary position, will have no legal effect.

Source: [TS-661-SC-2016]

3. For deeming an assessee as 'assessee in default', show cause notice needs to be issued within reasonable time

Bharti Airtel Limited ("the assessee") is a telecommunication service provider who engages the services of both domestic (resident) and foreign (non-resident) entities for providing interconnections to users. During FY 2001-02 to 2010-11, the assessee had taken services from some foreign (non-resident) entities and failed to deduct TDS on the same.

The revenue observed that the assessee had violated the provisions of section 201 by failing to comply with the TDS provisions and is liable to pay interest under section 201(1) and therefore issued a show cause notice.

The matter travelled to the High court of Delhi and the assessee argued that section 201 does not specifically mention for payments made to non-residents and only prescribes a time imitation for deeming one to be an assessee in default for residents. The assessee also contended that the show cause notice were barred by limitation period.

The revenue contended that the limitation period for payments made to non-resident is unfeasible as it may not be administratively possible to recover the tax from non-residents. Further it argued that when the parliament consciously provided no period of limitation, even while doing so for domestic taxpayers, the court could not in effect, place a period of limitation.

The High Court duly considered the facts of the case and arrived at the following conclusion:
Section 195(2) provides a remedy by which a person may seek a determination of the appropriate proportion of such sum so chargeable where a proportion of such sum so chargeable is liable to tax. Therefore, the only reason cited by the revenue i.e. administrative convenience, cannot outweigh the harsh nature of the consequence, which would require the resident assessee to maintain books and documents for an uncertain period of time.

The High Court therefore accepted the assessee's contention and ruled that a limitation period of four years would be a reasonable period for the issue of show cause notice.

Nangia's Take

This ruling provides much awaited relief against the hardship faced by the assessees making payment to non-residents of maintaining records for an uncertain period of time in respect of foreign payments. Providing a limitation period for initiation of proceedings under section 201 of the Act, shall act as a deterrent to the tax officers initiating frivolous TDS proceeding.

Source: [Bharti Airtel Limited; (2016) 76 taxmann.com 256 (Delhi)]

TRANSFER PRICING

4. The Tribunal explicated the concept of 'location savings' and thereby set aside the ad-hoc adjustment made on account of 'cheap labour' benefits derived by taxpayer

Facts of the case

Syngenta India Limited, ("the taxpayer') is in manufacturing and trading of agro-chemical products/crop protection chemicals and multiplication and trading of seeds. The Transfer Pricing Office ("TPO"), while concluding the TP assessment proceedings, had made upward adjustment in income of taxpayer on account of "location savings". While doing so, the TPO was of the view that the taxpayer derived local benefits, while undertaking its manufacturing activities in India and thereby derived benefits in form of cheap labour. The TPO determined the amount of adjustment (on account of location savings) by attributing 50% of the share of difference between the costs of employees globally less the cost of employees in India.

The aforesaid adjustment were confirmed by the Dispute Resolution Panel and aggreived with the same, the taxpayer filed an appeal before the Income Tax Appellate Tribunal ("the ITAT"/ the Tribunal").

Tribunal's Ruling

The ITAT noticed that Indian TP provisions do no warrant separate benchmarking of location savings derived by the entity vis-à-vis the labour cost and other factor of production. The provisions do not suggest any kind of adjustment on account of measuring the allocation of profits of group entities operating in different tax jurisdictions and thus, are deriving location saving benefits. Taking a cue from OECD TP guidelines, the ITAT clearly explained that the concept of location savings can be recognized in the event of re-allocation of activities or business restructuring of activities of the multinational group to a place where the costs are lower than the location where such business activities were initially performed. The Tribunal also explicated that in order to benchmark location savings, it is also required to have a suitable comparable data. In this connection, the Tribunal also referred the OECD's BEPS Action Plan – 8, which recommends the following steps to be followed whereby location saving benefits can be shared amongst the group entities:

- *Identify if location savings exists;*
- *Determine the amount of any net location savings;*
- *Measure the extent to which locational savings are either retained by a Member or Members of the MNE Group or are passed on to independent customers or suppliers;*
- *Identify where locational savings are not fully passed on to independent customers or suppliers, the manner in which independent enterprises operating under the similar circumstances would allocate any retained net location savings.*

Lastly, the ITAT clarified that as the taxpayer's transactions with its AEs were benchmarked under Transactional Net Margin Method ("TNMM") [which have been analyzed later to be at arm's length], any advantage on account of location saving would have already been embedded in the margins of the taxpayer and the comparables. In the light of the above findings/ observations, the ITAT deleted the captioned adjustment.

Nangia's Take

Owing to the absence of guidance on 'location saving' concept in Indian TP regulations, the Indian Courts has analyzed the same again, so much in detail, with referring to OECD TP Guidelines and its BEPS Action Plan in the instant case. The ruling clearly provides that the lower tax authorities cannot make adjustment on account of location savings (or in other way) in a generalized matter. The same needs to be supported with relevant findings which affirm benefits derived by the taxpayers on account of locational savings in the light of existence of comparable data to benchmark the same as well.

Syngenta India Ltd Vs. DCIT [TS-988-ITAT-2016(Mum)-TP]

international transaction at 50:50 ratio on the grounds that either of the two methods could be used and not both for benchmarking the transaction under review. The Tribunal also observed that the lower authorities failed to appreciate the fact that when once the transaction benchmarked under the provisions of Section 92 of the Income Tax Act, 1961 is approved, then there is no need to attribute the profits separately to the taxpayer's PE. In the light of the same, the Tribunal dismissed the appeal of the Revenue and concluded that CIT(A) is justified in restricting the adjustment to INR 54 lakhs.

Nangia's Take

The instant case underlines the fact that the Indian TP legislation does not provide for the simultaneous application of two TP methodologies when through one method the taxpayer reasonably justifies the arm's length nature of its international transaction. Additionally, it is also pertinent to note that once the transaction undertaken by a Indian PE of a foreign entity appropriately meets the ALP criteria then the question of attributing the profit in India for the same transactions separately does not arise.

Source: DCIT Vs. Mori Seiki Co Ltd [TS-724-ITAT-2016(DEL)-TP]

INDIRECT TAX

5. Inclusion of Tour Operators and Rent-a-cab services within the ambit of 'Input Services' – The High Court

Respondent, M/s. Visteon Automotive Systems India (P) ("Respondent") has availed the CENVAT Credit facility on input services of tour operators for transportation of their employees to the factory and the rent a cab service for official purpose of the company. Show Cause Notices (SCN) were served on Respondent disallowing to avail the CENVAT Credit on the ground that tour operator and rent-a-cab services do not fall within the ambit of definition 'input service' specified under Rule 2(1) of the Cenvat Credit Rules, 2004.

The Commissioner (Appeals) passed an order disallowing the claim of the Respondent mainly on the ground that neither the tour operator nor rent-a-cab services have any nexus with the manufacture of goods. Aggrieved by the said order, the Respondent filed an appeal before the Tribunal, who set aside the order.

Revenue filed an appeal before the High Court against the order of Tribunal.

Hon'ble High Court observed and ruled as under-

- The word "includes" in the definition of Input Services under Rule 2(1) of the Cenvat Credit Rules, 2004 gives wider meaning covering services in relation to manufacture or clearance of final products or in relation to providing output service has to be given a wider meaning and not a restricted meaning.

- High Court observed that the word Business means a commercial enterprises or establishment.

- Availing of such services is necessary to the manufacture and transporting the workers to and fro from the factory is included under input service, in relation to the manufacture of excisable goods.

- High court held that services availed has nexus to the manufacture of goods. The extended service defines not only input services but includes picking up workmen and services of cabs are used for the official purpose of the workers to the factory, the services could be considered as input services that is used in relation to the manufacture of excisable goods

[Source: Commissioner of Central Excise III vs. Visteon Automotive Systems]

6. Eighth GST council meet: No agreement on dual control

With the states and the Centre in a deadlock over the important issue of dual control, April 1 deadline for GST rollout may be missed. The GST Council does not reached any agreement on the issue of dual control and cross empowerment of businesses in the eighth round of meeting.

Highlights of Eighth GST Council Meeting:

- Model IGST law and several other procedural issues were discussed by GST Council during the first day of council meet.

- Various sectors like telecom, banking and insurance also made presentations to the council asking for a single registration under the GST.

- Coastal states pressed for rights to levy GST on trade of goods within 12 nautical miles offshore.

- Commerce Ministry has sought exemption from the GST for the leather and plantation sectors and exporters importing capital goods under special incentive schemes.

- States now claim that after demonetisation the compensation is expected to go up to Rs 90,000 crore as most states have seen revenue decline of up to 40 per cent.

Nangia's Take

Although GST has been delayed, government is still optimistic for GST to be rollout in June 2017 as GST is a transaction tax, can be brought in at any time. Dual control has been one of the key issues preventing Central Government from meeting the April 1st deadline. The GST Council will meet again on 16th January to hammer out the differences on which assessees will be controlled by states and who would be governed by centre.

7. Centre aiming April, 2017 for GST roll out

- Government still aims to roll out GST from April, 2017 and hopeful to resolve all the issues that are deadlocks for implementation of GST.
- Few critical issues which are pending are expected to be sorted out in the next few weeks, as government wants to implement GST in April, 2017

Highlights

- GST which would subsume most of the central and state taxes like excise, service tax and VAT, needs to be rolled out latest by September 16.
- Finance minister Arun Jaitley said at the Vibrant Gujarat Global Summit:
  - "The deadline to implement GST is September but **we are committed for its implementation from April**"
  - "We would want it to be implemented from April if all issues are resolved. But implementing it before September 16 is a necessity,"
  - "There is a provision for GST implementation because constitutional amendment has been passed. So it's Constitutional necessity that before September 16 it should be rolled out"