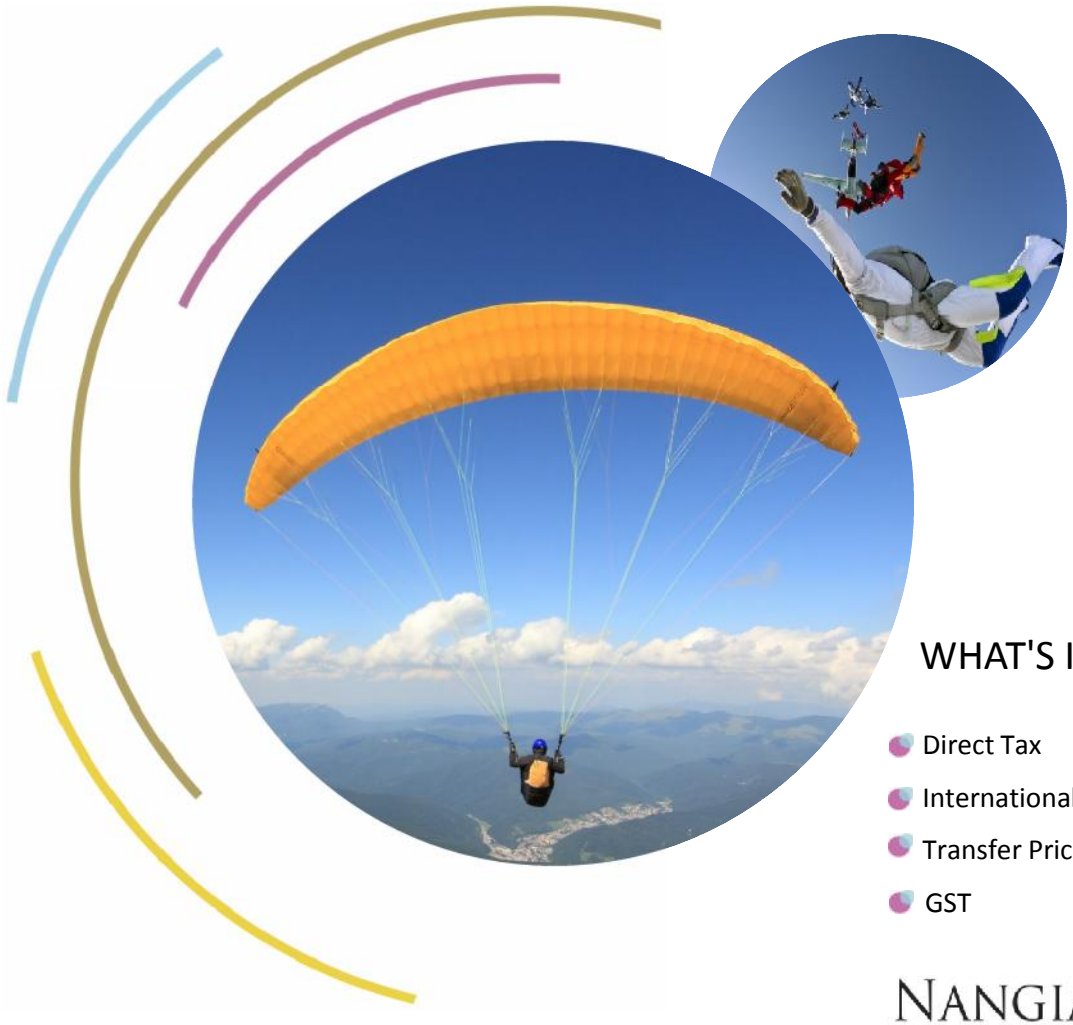
NEWS CRUNCH

October 16- 31, 2017



WHAT'S INSIDE...

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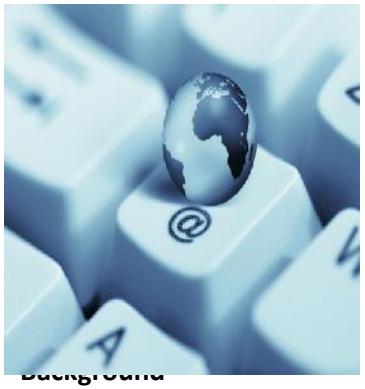
- GST

NANGIA & CO LLP
CHARTERED ACCOUNTANTS

What's inside . . .

DIRECT TAX

1. Loans or advances given to a concern is taxable as deemed dividend in the hands of shareholder and not the concern



The Apex Court of India dealt with the issue of whether loans/advances received by a concern from a closely held company, the shareholder of which has a substantial interest in the concern, can be taxed as deemed dividend in the hands of the concern under the provisions of the Income-tax Act, 1961 ('the Act') or is to be taxed in the hands of shareholder of such closely held company.

Background

The Act provide for deemed dividend taxation in respect of payment by a closely held company by way of advances or loans 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 has a substantial interest (20% or more) in the said concern.

The issue whether the taxation of deemed dividend should be in the hands of the concern receiving the loans/ advances or the same should be in the hands of the shareholder of the closely held company extending such loans/advances has been a subject matter of controversy and has variant conflicting jurisprudence.

- The Special Bench in the case of **Bhaumik Colour**[1] ruled that the deemed dividend should be taxable in the hands of the registered shareholder and not the concern.

- However, the Central Board of Direct Taxes (CBDT) in its Circular No. 495 dated 22 September 1997 clarified that legislature intent was that amount received in the form of advances or loans which is deemed as dividend is taxable in the hands of the concern i.e., the recipient.

In the present case, the assessee, an Indian company (A Co.), had received advances from another Indian company (B Co.). The shareholders of the A Co. and B Co. were common and held substantial holding in both the companies. The Tax Authority contended that the amount received by the A Co. from B Co. would constitute 'advances and loans' and, thereby, taxable as deemed dividend under the Act in the hands of A Co. who is in receipt of advance.

Assessee's contention

The assessee contended that deemed dividend can be taxed only in the hands of registered shareholder and since the assessee was not the shareholder, deemed dividend cannot be taxed in its hands. The assessee argued that as it is not a shareholder of B Co. and, hence, the amount received cannot be regarded as deemed dividend.

The Tribunal ruled in favor of the assessee placing reliance on the Special Bench decision in the case of **Bhaumik Colour** as affirmed by Bombay High Court in the case of **Universal Medicare**[2]

Ruling of the Apex Court

The Apex Court affirmed the ruling of the Delhi High Court and observed that the high court has laid down the correct construction of deemed dividend provision under the Act. The high court had ruled that the advances/loans received by a concern from a closely held company should not be taxable in the hands of the concern but in the hands of the shareholder. The High Court ruled as below:

- Intent of the law behind introducing deemed dividend provision is to tax dividend in the hands of shareholder with a view to overcome the tendency of the closely held company which is controlled by shareholders not to distribute dividend which is a taxable event and instead to provide funds by way of loans or advances to shareholders or their concerns.

- Deeming provisions as it applies to the case of loans or advances by a company to a concern is based on the presumption that the loans or advances would ultimately be made available to the shareholders of the company giving the loans or advances.

- The legal fiction created under deemed dividend provision results in expansion of the definition of 'dividend'. Legal fiction created by the Legislature has to be taken to a 'logical conclusion'. In absence of the definition of 'shareholder' being enlarged by any fiction, deemed dividend cannot be taxed in the hands of the concern.

1118 ITD 1 (Mum.)
324 ITR 263

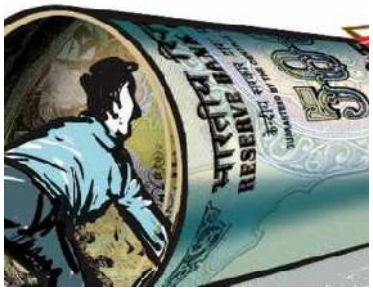
[2] 324 ITR 263

NANGIA'S TAKE

This Apex Court ruling puts to rest the controversy of whether the deemed dividend on account of grant of loans/advances to a concern in which shareholder has substantial interest should be assessed in the hands of shareholder or in the hands of concern receiving the amount, and held that the deemed dividend on account of loans/advances is taxable in the hands of the shareholder and not the concern.

Source: TS-462-SC-2017

2. CBDT issues POEM clarification for operations carried on through regional headquarters



Background

- A foreign company is treated as a resident of India if its place of effective management ('POEM'), in a given year, is in India. In this regards, the Central Board of Direct Taxes ('CBDT') had, vide a circular dated 24 January 2017, issued guidelines for determination of POEM of foreign companies in India.

POEM Guidelines provide that the determination of POEM should primarily be based on whether or not a company has "active business outside India" ('ABOI'). For companies that satisfy the ABOI test, POEM is deemed to be outside India if majority of the board meetings are held outside India unless facts suggest that the board of directors is not the de facto decision-making authority. POEM Guidelines also provide that merely because the board of directors follows the general and objective principles of the global policy of the group laid down by the parent entity in the fields of payroll functions, accounting, human resource (HR) functions, IT infrastructure and network platforms, supply chain functions, routine banking operational procedures, it would not constitute a case of the board of companies standing aside.

CBDT circular

Pursuant to the representations, the CBDT, vide the Circular dated 23 October 2017, has reiterated the clarification provided in the Guidelines applicable to ABOI companies to the extent it relates to adherence to the group policy.

The Circular provides that if MNCs have their Regional Head Quarters in India, this fact may not constitute a case of the board of the foreign subsidiaries/ group companies in the region standing aside and there will be no establishment of POEM provided:

- The Regional Head Quarter operates for such subsidiaries/ group companies in the region within the general and objective principles of the global policy of the group laid down by the parent.
- The global policy is in the fields of pay roll functions, accounting, HR, IT infrastructure and network platforms, supply chain functions, routine banking operations.
- The global policy is not specific to any entity or group of entities per se.

However, in cases where the above clarification is found to be used for abusive/ aggressive tax planning the same may be subject to GAAR.

NANGIA'S TAKE

This Circular is a reiteration of the law maker's intention of safeguarding India's attractiveness as a global talent hub. The Circular is by way of a clarification and, accordingly, will apply from tax year 2016-17 and onwards. The clarification will apply to both outbound as well as inbound regional headquartered groups, but may not extend to pure investment or holding companies. This has relevance only to a foreign company whose predominant income is active income. If major income of the foreign group/ subsidiary company in the region is by way of, say, dividend or royalty, such company is unlikely to fulfil the ABOI test and thereupon the content of the clarification in the Circular may not be applicable for such companies. Accordingly, the MNCs may need to evaluate the clarification in the Guidelines while assessing the impact of their global policies.

3. Premature redemption of debt instrument with backended return is a permissible tax planning

In case of Nirma Ltd. v. ACIT ('the Assessee') the issue before the Gujarat High Court was tax deductibility of premium paid on pre-mature redemption of debentures classified as "Special Purpose Notes" (SPNs) under a specific provision of the Income-tax Act, 1961 ('the Act'), which grants deduction for interest in respect of capital borrowed for the purposes of business.

Background

The Assessee, a public limited company, is engaged in the business of manufacturing of detergent powder, detergent cake, toilet soap, shampoo and other consumer products. During the tax year 1996-97, it has set up a soda ash manufacturing plant as a measure of backward integration for captive manufacture of soda ash required as a raw material for manufacturing of soaps and detergents.

The project was funded by a combination of various sources such as rupee and foreign currency term loans from (FIs, internal accruals, from shareholders of an amalgamating company and balance from rights issue of Non-Convertible Debentures (NCDs) and Special Purpose Notes (SPNs) with share warrants from shareholders. Tax Authority sought to disallow premium on various grounds; the primary objection being that the entire exercise of issue of SPNs which involve subscription predominantly by family members and entities belonging to the promoter group, announcement of premature redemption with prior approval from SPN holders after 3 years, sale of SPNs by Promoter Group to banks

and financial institutions (FIs) and premature redemption thereof by the Assessee, was a colorable transaction devoid of business purpose to avoid tax.

In tax year 1999-2000, the Assessee obtained approval from holders of NCDs/SPNs (from majority holders; representing at least three-fourth of the outstanding amount) and announced premature redemption thereof at a premium. The premium included an extra premium of INR 37.86 per SPN and INR 21.54 per NCD for early redemption. The Assessee conveyed the decision to stock exchanges, fixed record date of 10 March 2000 as date of premature redemption and 15 March 2000 as date of prepayment.

The NCD/SPN subscribers transferred their holding to banks and FIs just prior to the record date at a small discount to the redemption amount which enabled the banks and FIs to make a small profit on purchase and redemption of NCDs/SPNs. The NCD/SPN subscribers offered the gains on sale to banks and FIs as long-term capital gains taxable at lower rate than interest income

Contentions of the Assessee

The Assessee claimed the whole of the premium paid on SPNs as deductible expenditure for tax year 1999-2000 under the specific provision which grants deduction for interest in respect of capital borrowed for the purposes of business.

Contentions of the Revenue

The Tax Authority's objections to the grant of deduction of premium were as follows:

- The borrowing was for capital expenditure. The interest on such borrowing cannot be allowed as deduction.
- The Assessee was in the process of setting up a new industry. The borrowing was not for the purposes of expansion or extension of an existing business.
- The liability for premium had not accrued and was merely a contingent liability.
- The entire transaction was a sham and colorable device to defraud the Tax Authority and avoid tax.

Ruling of the Gujrat High Court

The High Court allowed the deduction by holding that the entire scheme was motivated by a genuine requirement of funds for the Assessee's new project, executed in a transparent manner and, hence, it can only be seen as a clever but permissible tax planning and not a sham or colorable device. The High Court held that there is always a line, though not always clear, between legitimate tax planning and sham or bogus device to defeat a genuine claim of the Tax Authority. The High Court also upheld the principle that a taxpayer is free to raise funds required for its business in the form and manner of his choice. Further, a common decision by all members of Promoter Group as per option available to all shareholders in general is not indicative of any hidden design. Mere early redemption also would not be enough to hold that from the inception there was a device created by the Taxpayer to defeat Tax Authority's interests.

NANGIA'S TAKE

This ruling pertains to a year prior to the introduction of statutory General Anti Avoidance Rules in the Act with effect from 2017-18. The ruling illustrates application of judicially settled principles on tax planning where the courts have upheld a legitimate tax planning within the framework of law without involving any colorable devices or sham transactions. Taxpayer is free to raise funds required for its business in the form and manner of its choice. Importantly, this ruling has upheld the principle that a transaction motivated by a genuine business need and carried out in a transparent manner with full information in public domain following due process of law cannot be regarded as colorable device or a sham transaction.

4. ITAT Bangalore rules that once the nature of payment attracts TDS provisions, it would not change the obligation of the assessee to deduct tax at source even if the payment is "routed as reimbursement" to another company

Brief Facts of the case :

- Tungabhadra Steel Products Ltd. **("Assessee")** is a subsidiary company of M/s Bharat Yantra Nigam Ltd. **("Holding Company")**, engaged in architectural, engineering and other technical activities.
- Assessee had taken loan from Govt. of India on which it was liable to pay interest. Assessee debited the said interest in Profit & Loss Account even though it did not actually pay the interest and thus, the said amount stood as a liability of the assessee as at Balance Sheet date.
- The revenue disallowed the interest expense on the ground that assessee had no intention to pay the interest and it was covered under provisions of Section 43B of the Income Tax Act **("Act")**.
- During the year under consideration, the assessee had also made payment (without deducting tax at source) to its Holding Company claiming them to be reimbursement of expenses incurred by the holding company on its behalf on account of management charges.

- The revenue disallowed the same u/s 40(a)(ia) on the ground that the said amount was covered by TDS provisions of Section 194J of the Act.

- On appeal by the assessee, the Commissioner of Income Tax(Appeals) **("CIT(A)")** passed the order in favour of the assessee against which, the revenue appealled before the Income Tax Appellate Tribunal **("ITAT").**

Contentions of Revenue:

- As per Revenue, the assessee had been declared a "sick company" during the year under consideration and had filed its application under BIFR. Thus, it had no intention to pay the interest. The assessee had only debited interest on provisional basis.

- As per Revenue, interest on Govt. loan was nothing but statutory dues and to be allowed only on payment basis.

- As regards, reimbursement of expenses, revenue submitted that merely because the payment is routed through the holding company, it will not relieve assessee from the liability of deducting tax at source. Section 194J is applicable in case of management fees paid.

Contentions of Assessee:

- None appeared on behalf of assessee.

Ruling of the ITAT:

- As regards interest on loan, ITAT agreed with the view of CIT(A) that interest liability on a loan cannot be made on provisional basis **as it is an actual liability** and an expenditure allowable under the Act.

- Further, the said interest does not fall under the provisions of Section 43B. Hence, interest payable on Govt. loan is allowable under the Act on accrual/due basis.

- As regards management fees, ITAT held that even if the said payment was on account of reimbursement of expenses incurred by holding company, the provisions of Section 194J cannot be circumvented by modus operandi of payment routing through the holding company.

- Once the nature of payment is clearly attracting the provisions of Section 194J, the modes of payment will not change the obligation of assessee to deduct tax at source.

- If this modus operandi is allowed then in each and every case, the provisions of Section 194 as well as Section 40(a)(ia) can be circumvented by making the payment through an intermediary.

Thus, ITAT disallowed the said expenses u/s 40(a)(ia) and appeal was partly allowed in favour of revenue.

NANGIA'S TAKE

In this case, the Tribunal has taken a strong view regarding TDS liability in cases of reimbursement of expenses, which may also be applicable for inter-corporate cost sharing and allocation of expenses amongst group entities. It may be noted that while taking this view, the Tribunal has apparently not considered an aspect that if the first payer, who is making direct payment to third party vendor, has already discharged TDS liability on such payment, whether the same transaction may be again subject to TDS when such cost is partly or wholly allocated/ cross charged to another entity. This decision may have a significant impact on cross-border cost allocations/ reimbursements, on which no TDS is deducted, neither by first payer who is located outside India nor by Indian party, which makes cost to cost reimbursement without any profit element. Revenue authorities may use this decision to impose TDS liability in all cases of re-imbursement and pierce the corporate veil to such extent.

5. Apple Among Giants Due for Foreign Tax Bill Under House Plan

Several of the biggest U.S. companies -- including Apple and Procter & Gamble -- would no longer be able to escape taxes on the trillions in overseas profits they've accumulated, under a tax bill released by House Republicans.

Earnings held in cash would be taxed at 12 percent while profits invested in less liquid assets like factories and equipment face a 5 percent rate, according to the legislation released Thursday. Both taxes would be mandatory, not optional, and companies would have as long as eight years to make their payments on an annual basis. The provision would raise an estimated $223 billion over the next decade.

The 12 percent rate is "borderline of being business unfriendly," said Steven Englander, head of research and strategy at Rafiki Capital Management. "It's not a game changer, but the changing tone is a disappointment. It's gone from the way forward for the tax system to a piggy bank to pay for the tax cuts."

Source:https://www.bloomberg.com/news/articles/2017-11-02/house-bill-would-tax-offshore-corporate-profit-at-up-to-12

6. House GOP Tax Plan Sticks with Big Corporate Cuts

House Republicans unveiled the details of the biggest transformation of the U.S. tax code in more than 30 years, calling for deep cuts in business-tax rates and starting a race to pass the complex legislation by year's end. The plan calls for chopping the corporate tax rate to 20% from 35%, compressing individual income-tax brackets, and eventually repealing the estate tax. The Tax Cuts and Jobs Act seeks the biggest transformation of tax code in more than 30 years; leaves top individual tax rate at 39.6%.

Source: https://www.wsj.com/articles/republicans-stick-with-big-corporate-tax-cuts-in-house-bill-1509629510

7 . Korea urged to introduce robot tax

Future technologies represented by artificial intelligence (AI) are already expanding their influence on people's lives.

From Google DeepMind's AlphaGo series systems to IBM's Watson system, AI and robotic technologies are already around us. The former overwhelmed human go masters, including Korea's Lee Se-dol and China's Ke Jie, while the latter penetrated into meetings of surgeons to offer calculated medical suggestions.

Expectations are mixed over the influence of such new technologies on the job market. Whereas many workers worry about being replaced by automated machines with artificial intelligence, U.S. market tracker Gartner said otherwise.

In its projection of the near future after 2018, Gartner said the introduction of AI technologies at workplaces will decrease the number of jobs around the globe between 2015 and 2019 but will start to create more jobs in 2020 than it had destroyed.

In this context, experts here urged that Korea should start taking a closer look into the introduction of "robot tax" and use the national income to retrain human resources for new jobs.

Source:
https://www.koreatimes.co.kr/www/tech/2017/11/133_238629.html

8. UK is subsidising Isle of Man to be tax haven, say campaigners

The British government has paid the Isle of Man more than £300m this year in a revenue-sharing deal that critics claim is subsidising the island's zero corporation tax rate.

The arrangement, which was not disclosed to parliament, means the UK's payments to the Isle of Man will be substantially increased at a time when the economy is growing slowly.

Tax campaigners say this means the UK is in effect subsidising the island to be a tax haven. The funding formula dates back to the 18th century and is underpinned by a customs union between the Isle of Man and the UK.

Source:https://www.theguardian.com/news/2017/nov/07/uk-isle-of-man-subsidy-tax-haven-common-purse-payments

TRANSFER PRICING

9. The ITAT declined departure from the principle of res-judicata; held that AMP intensity adjustment is not a distinguished factor

Facts of the case

Louis Vuitton India Retail Private Limited ("the taxpayer") is a subsidiary of Louis Vuitton Malletier SA, France and is engaged in importing goods (i.e. products include fashion accessories, leather bags and shoes) from group entities and selling the same within Indian markets. During the assessment year under review, the taxpayer undertook certain international transactions with its associated enterprise ("AE") involving import of goods, window display, packaging material, brochures and catalogues, and reimbursement of expenses. The taxpayer applied Resale Price Method ("RPM") while valuing import transactions and Comparable Uncontrolled Price ("CUP") method for reimbursement of expenses. The case was picked up for scrutiny wherein the Transfer Pricing Officer ("TPO") observed that the taxpayer has incurred huge expenses on account of Advertisement, Marketing and Promotion ("AMP")

and proposed an adjustment of INR 9.75 crore on "***substantive basis"*** by intensity adjustment applying Cost Plus Method ("CPM"). Alternatively, the TPO further proposed an adjustment of Rs 6.64 crore by applying Bright Line Test ("BLT") on ***"protective basis"***. The matter was referred to the Dispute Resolution Panel ("DRP") which upheld that the adjustment be made on a protective basis. The Assessing Officer ("AO") in his order made an addition of Rs 9.75 "crore on a substantive basis. Aggrieved with the decision, the taxpayer filed an appeal before the Income Tax Appellate Tribunal ("the ITAT"/ "the Tribunal").

Proceedings before the Tribunal

Taxpayer's plea

Before the ITAT, the taxpayer contended that a similar issue had come up before a different bench of ITAT in the taxpayer's own case in previous assessment year wherein the matter was restored to the file of AO/TPO for a fresh consideration. The taxpayer highlighted that the instant case, on account of certain distinguished features (e.g. AMP intensity adjustment) was different from preceding years on account of AMP adjustment and therefore the matter ought to be adjudicated by the Tribunal itself. The taxpayer also contended that restoring the matter to the TPO for fresh consideration will be of no use as the TPO had relied on certain High Court ("HC") judgments before passing his order.

The ITAT's verdict

The Tribunal took cognizant of the taxpayer's plea relating to non-restoring of the matter under dispute back to the files of AO/TPO.

However, the Tribunal clarified that the AO, in its final order, did not make any addition by applying AMP intensity adjustment which does not eventually distinguishes the matter of the instant assessment year from previous assessment year in taxpayer's case. The ITAT further cited that though the TPO had relied upon certain judgments of the Hon'ble High Court ("HC") while passing its order earlier, there are certain other judgments which have delivered after passing of the order by TPO and could not be relied upon owing to their nonexistence. The ITAT noted that a similar issue was restored to the file of AO/TPO and cited the judgments in the cases of **Rayban Sun Optics India Ltd [TS-782-HC-2016(DEL)-TP]** and **Bose Corporation (India) Pvt. Ltd. [TS-702-HC-2016(DEL)-TP]**. The ITAT concluded by restoring the matter of determination of international transaction to the file of AO/TPO by stating that if the same found not to exist, the matter there and then.

NANGIA'S TAKE

The ITAT, in instant case, based on the findings of the Indian courts in several other cases, have also disapproved the use of BLT approach for benchmarking excessive AMP expenses. The ITAT also clarified that AMP intensity adjustment made in year under review cannot be the distinguished factor for non-referring the case of the taxpayer to the files of AO/ TPO as done for previous assessment year by co-ordinate bench.

Source: Louis Vuitton India Retail Pvt Ltd [TS-794-ITAT-2017(DEL)-TP]

10. GST council cuts Tax rate on items falling under 28 per cent slab

- The GST Council in its 23rd Council meeting held at Guwahati on 10th November 2017, slashed tax rates on approximately 200 items including beauty products, chewing gums, chocolates, coffee, and custard powder, among others, from 28 per cent to 18 per cent.

Highlights:

- Tax rates on over 200 items, including beauty products, chewing gums, chocolates, coffee, and custard powder, among others, were slashed from 28 per cent to 18 per cent. The top tax rate is now restricted only to luxury and demerit goods like pan masala, aerated water and beverages, cigars and cigarettes.

- All taxpayers would file FORM GSTR-3B along with the payment of tax by 20th of the following month till March, 2018 irrespective of the turnover limit.

- Taxpayers with annual aggregate turnover upto Rs. 1.5cr would file GSTR 1 on quarterly basis till March 2018.

Period	Dates
July-Sep	31st Dec 2017
Oct-Dec	15th Feb 2018
Jan-Mar	30th April 2018

- Taxpayers with annual aggregate turnover more than Rs. 1.5cr would need to file GSTR 1 on monthly basis till March 2018.

Period	Dates
July-Oct	31st Dec 2017
Nov	10th Jan 2018
Dec	10th Feb 2018
Jan	10th Feb 2018
Feb	10th Apr 2018
March	10th May 2018

- Till March 2018, filing of GSTR-1 will continue without requiring filing of GSTR-2 & GSTR-3 for the previous month / period.

- The time period for filing GSTR-2 and GSTR-3 for the months of July, 2017 to March 2018 would be worked out by a Committee of Officers.

- In cases where late fees was paid by the tax payers, the late fees paid will be re-credited to their Electronic Cash Ledger under "Tax" head instead of "Fee". The amount credited will be used for discharging future tax liabilities.

- For taxpayers having NIL tax liability, late fees for subsequent months, i.e. October 2017 has been revised to Rs. 20 per day.

Extension in due dates:

S. No.	Form and Details	Original Due Date	Revised Due Date
1.	GST ITC-04 for the quarter July-September, 2017	25.10.2017	31.12.2017
2.	GSTR-4 for the quarter July-September, 2017	18.10.2017	24.12.2017
3.	GSTR-5 for July, 2017	20.08.2017 or 7 days from the last date of registration whichever is Earlier	11.12.2017
4.	GSTR-5A for July, 2017	20.08.2017	15.12.2017
5.	GSTR-6 for July, 2017	13.08.2017	31.12.2017
6.	TRAN-1	30.09.2017	31.12.2017 (One-time option of revision also to be given till this date)

- Annual turnover eligibility for composition scheme will be increased to Rs. 2 cr. from the present limit of Rupees 1 cr. under the law. Thereafter, eligibility for composition will be increased to Rs. 1.5 cr. per annum.
- Composition dealers shall have the uniform rate of 1% for manufacturers and traders.
- Supply of services by Composition taxpayer upto Rs. 5 lakh per annum will be allowed by exempting the same.
- Restaurant services will have a flat rate of 5%.
- Facility for manual filing of application for advance ruling is being introduced for the time being.

NANGIA'S TAKE:

The relaxations in the return filing along with the reduction in tax rates of various commodities is a welcome move. Cheaper tax rates on approximately 200 items has provided a big relief to the businesses as well as to the common man. Ease of the compliance burden further till March 31st is also a big comfort provided to the taxpayers till they get used to the new tax regime.