NEWS CRUNCH

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NANGIA & CO LLP
CHARTERED ACCOUNTANTS

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DIRECT TAX

1. Delhi Tribunal holds that Erection, installation, testing and commissioning charges not taxable as FTS

Brief Facts of the Case:

- Lalitpur Power Generation Co. Ltd ("Assessee"), is engaged in the business of generation of power by setting up of a supercritical thermal power plant in UP. It is a special purpose vehicle by the government of Uttar Pradesh for implementation of the power project.
- Assessee entered into a contract with Bharat Heavy Electricals Ltd ("BHEL") for availing transportation, insurance, erection, installation, testing, commissioning services and withheld tax on the payment under section 194C of the Income-tax Act, 1961.
- Assessing Officer ("AO") was in the view that the services provided by BHEL to the Assessee are in the nature of fees for technical services ("FTS") on which tax should be deducted under section 194J of the Income-tax Act, 1961.

Assessee's Contentions

Assessee contended that scope of the work given to the sub-contractors is for erection, testing, commissioning and trial operation and handing over of boiler units, electrostatic precipitators etc. which involved construction work, welding, erection, alignment, transportation of equipment and materials with the help of machines which did not fall within the scope of technical services as defined in Explanation 2 to section 9(1)(vii) of the Act.

❖ What the Assessee was to get from the contractor was a physical output, the tangible structure and not merely the services of the qualified engineers/staff. The services of qualified engineers and skilled manpower were utilized for this purpose which was inevitable. Merely because technical personnel are employed in the execution of the contract it does not follow that the contract is one for technical services.

Revenue's Contentions

❖ Revenue contented that the service of testing and commissioning is specialized technical work performed by the technically competent manpower and therefore services are fees for technical service ("FTS") and requiring tax withholding under section 194J of income-tax Act, 1961.

Tribunal's Judgment

❖ While deciding the issue, Tribunal relied on the judgement of Hon'ble Punjab and Haryana High Court in Pr. CIT Vs. Bharat Heavy Electricals Ltd ("390 ITR 322") rendered on similar issue and similar fact pattern.

❖ Tribunal held that personnel that are required to test and commission the plant and equipment perform their functions not under a contract for the supply of technical services to the customer but to satisfy the customer on behalf of the contractor that the plant and equipment has been duly supplied as per the contractual specifications.

❖ Tribunal further held that the contract entered between the Assessee and each of the contractors did not involve the supply of professional or technical services at least within the meaning of section 194J. The consideration paid under the contracts, therefore, was not for the professional or technical services rendered by the contractors to the Assessee.

❖ Tribunal further held that the Revenue was not correct in arguing that if a contract did not fall within the ambit of section 194C, it must be deemed to fall within the ambit of section 194J. Sections 194C and 194J are independent provisions.

NANGIA'S TAKE

The ruling specifically points out important principle that sections 194J and 194C are independent sections and non-applicability of one particular section does not automatically throws open applicability of the other section. Further, the Tribunal also lays down an important principle in relation to installation, construction and commissioning contracts that in such contracts, essence is not provision of service but supply/ erection of the structure and thus, such services should not be classified as FTS. Though rendered in context of an Indian EPC contractor, this ruling could be important in context of non-resident EPC contractors as well for the purpose of determining withholding tax liability on such payments

2. Mumbai Tribunal holds that payment for marketing and business development services rendered outside India by a service provider is not taxable as Fees for Technical Services, either under the domestic tax laws or under India-Singapore DTAA, thus not liable to withholding tax in India

Brief Facts of the case:

- Fractal Analytics Pvt. Ltd. ("Assessee"), is engaged in the business of providing of predictive analytics for the retail financial services, insurance, consumer packaged goods and telecom.

- During the Assessment year under consideration, Assessee engaged Fractal Singapore ("FS"), its wholly owned subsidiary, for marketing and business development services provided by FS outside India and paid consideration for the same.

- Assessing Officer ("AO") and First Appellate Authority ("FAA") were of the opinion that above mentioned income is taxable as Fees Technical Services ("FTS") as per Section 9(1)(vii) of the Income Tax Act, 1961 ("Act") and Assessee should have withheld taxes on the same.

Assessee's Contentions

- Regarding allegation of the AO regarding services provided by FS were in nature of managerial, technical or consultancy services, Assessee contended that FS was neither engaged in controlling, directing, managing nor administrating the business of the assessee. Moreover, any portion of rendering of marketing and support services by FS did not involve application of industrial or other services which would require any sort of advice from FS.

- Assessee further contended that services rendered did not pass the 'make available" test as expounded in clause 4(b) of Article 12 of India- Singapore Double Taxation Avoidance Agreement ("DTAA"). FS being tax resident of Singapore is eligible to claim the benefit under DTAA since as per Section 90(2) of the Act, Non- Resident (NR) has the option to be governed either by the provisions of Act or treaty, whichever is more beneficial.

Tribunal's Judgment

- Tribunal held that FS was helping assessee in areas of business development as services were being provided from Singapore. It also concluded "it is a fact that FS had no PE in India and it had no authority to conclude any contract on behalf of the assessee."

- Tribunal further held that marketing services do not follow a common set of methods but are rendered using various tactics and negotiation strategies which are personal in nature and rather an "art" and thus can not be said to qualify as "technical service".

The Tribunal further held that such services could not also fall within meaning of "managerial service" or "consultancy service", and thus such payment could not be said to have fallen definition of FTS, as prescribed under the Act.

❖ Tribunal also held that "make available test" as specified under Article 12 of India-Singapore DTAA, was not satisfied. For a service to be made available, service recipient should be able to make use of the knowledge by itself which is not satisfied in this case.

❖ Tribunal also held that law prevailing at the time in force no income was arising in India by virtue of these services, so the provisions of Section 195 for withholding taxes on such remittance were not applicable.

❖ Ultimately, Assessee's appeal was allowed by the Tribunal, holding that Fees paid for business development services to subsidiary is not FTS, either under section 9(1)(vii) of the Act or under India- Singapore DTAA and thus not liable to tax in India and accordingly there was no requirement for Indian payer to withhold income tax on the same.

NANGIA'S TAKE

While this ruling of Mumbai Tribunal reaffirms the scope of "make available" clause under India-Singapore and other similarly worded tax treaties for the purpose of scope and definition of "Fees for Technical Services" under Article 12 of India-Singapore treaty, more importantly, the Ruling also holds that even under the domestic tax laws, marketing & business development services rendered outside India will not fall within scope and meaning of FTS (i.e. technical, managerial or consultancy services) under section 9(1)(vii) of the Act. This ruling is likely to benefit taxpayers from other treaty/ no-treaty countries also, providing similar services, where benefit of "make-available" clause is not available.

INTERNATIONAL TAX UPDATES

3. EU Requests OECD Review of U.S. Tax Law's Harmful Provisions

The European Union has tasked the OECD's forum on harmful tax practices with reviewing U.S. tax reform, the latest step in the bloc's scrutiny of the new law. The EU wants the OECD to conduct a "fast-track" review of the U.S. tax changes, following February discussions among EU finance ministers on how to react to the law, and whether to mount retaliatory measures in the World Trade Organization, an EU diplomat told Bloomberg Tax. The U.S. cut its corporate tax rate to 21 percent from 35 percent in the 2017 tax act (Pub. L. No. 115-97). The EU has been monitoring the situation for months, and has warned that several provisions—like a new base erosion and anti-abuse tax—may break international trade rules.

Source: https://www.bna.com/eu-requests-oecd-n57982089605/

4. Donald Trump threatens to impose "reciprocal tax" on India, China

US President Donald Trump threatened to impose a "reciprocal tax" on countries like China and India if they do not match America's tariffs, reiterating a warning he had made before while referencing India's import duties on Harley-Davidson motorcycles. On Friday, the government said the decision by the US to raise import duty on steel and aluminium is discriminatory and will have some impact on India.

"Of course, there would be some impact as India is an exporter," commerce secretary Rita Teaotia said. She said there is "disquiet" as the US has raised duties on certain items beyond the bound rates.

These are the rates that countries commit themselves to at the World Trade Organization (WTO) that can't be exceeded. These are different from applied rates, which are the actual tariffs.

Source: https://economictimes.indiatimes.com/news/economy/foreign-trade/donald-trump-threatens-to-impose-reciprocal-tax-on-india-china/articleshow/63233790.cms

5. Trump threatens to impose tax on European cars if EU retaliates against US tariffs

US President Donald Trump has threatened to impose a hefty import duty on European cars if the European Union retaliates against his steep tariffs on aluminium and steel.

Earlier this week, Trump officially announced tariffs of 25 per cent on steel and 10 per cent on aluminium, despite major opposition from his own party, triggering a possible trade war with China and Europe. The EU threatened an "arsenal" of retaliatory measures when the tariffs were first proposed, including imposing import tariffs on products made in red districts. Trump threatened to tax European-made cars if they retaliated against the aluminium and steel tariffs with their own taxes on US imports like Harley Davidson motorcycles, bourbon and blue jeans.

"The European Union, wonderful countries who treat the US very badly on trade, are complaining about the tariffs on steel and aluminium," Trump said in a tweet Saturday.

Source: https://www.hindustantimes.com/world-news/trump-threatens-to-impose-tax-on-european-cars-if-eu-retaliates-against-us-tariffs/story-jpUYGiURKT8DEhbs5eLtHL.html

6. EU set to add Bahamas, U.S. Virgin Islands to tax haven blacklist

The Bahamas, the U.S. Virgin Islands and Saint Kitts and Nevis are set toe added next week to a European Union blacklist of tax havens, raising to nine the number of jurisdictions on it, an EU document seen by Reuters shows.

The decision, taken by EU tax experts, is set to be endorsed by EU finance ministers at a regular monthly meeting on Tuesday, when the 28 EU governments are also expected to delist Bahrain, the Marshall Islands and Saint Lucia.

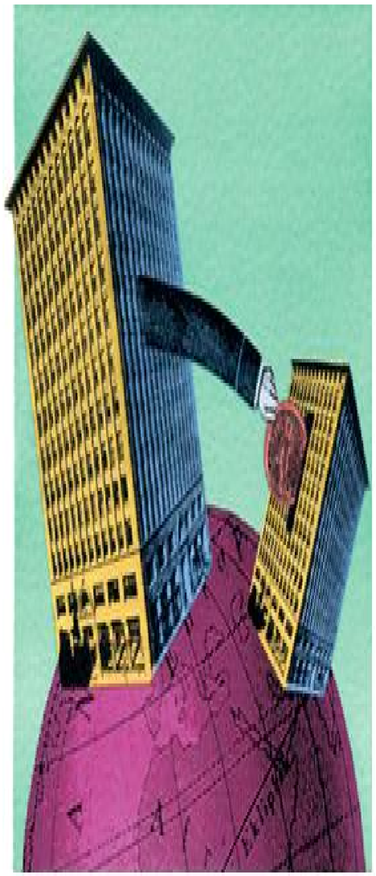
As a result of both moves, the blacklist would maintain nine jurisdictions deemed to facilitate tax avoidance. The other six are American Samoa, Guam, Namibia, Palau, Samoa and Trinidad and Tobago.

The document, prepared by EU officials and dated March 8, also adds Anguilla, The British Virgin Islands, Dominica and Antigua and Barbuda to a so-called grey list of jurisdictions which do not respect EU anti-tax avoidance standards but have committed to change their practices.

Source: https://www.reuters.com/article/us-eu-tax-blacklist/eu-set-to-add-bahamas-u-s-virgin-islands-to-tax-haven-blacklist-idUSKCN1GL1A4

TRANSFER PRICING

7. ITAT follows precedent and held that no interest adjustment is warranted when working capital adjustment considers outstanding receivables



Facts of the case

Kusum Healthcare Private Limited ("the taxpayer") is engaged in manufacturing, marketing and exporting of pharmaceutical products to its Associated Enterprise ("AE") viz. Glad Pharm Ltd., Ukraine as well as Non-AEs. The taxpayer exported finished pharmaceutical products to its AE during the Assessment Year ("AY") 2011-12 ("the year under consideration"). The taxpayer benchmarked the said international transaction using Transactional Net Margin Method ("TNMM") as the most appropriate method ("MAM") and considering AE as the tested party. Accordingly, the profitability of the tested party i.e. AE was compared with margin earned by comparable companies engaged in performing similar functions, wherein, the operating profit margin ("OPM") of the tested party was lower than the OPM of comparable companies.

Hence, the Transfer Pricing Officer ("TPO") accepted that the aforesaid international transaction was undertaken at Arm's Length Price ("ALP"). However, during the course of proceedings the TPO noticed certain trade receivables arisen as a result of international transaction undertaken by the taxpayer during the year under consideration were outstanding for more than 180 days and re-characterized them as unsecured loans advanced by the taxpayer to its AE and imputed notional interest using SBI Prime lending rate and proposed an adjustment for the same.

Further, the Dispute Resolution Panel ("DRP") confirmed the adjustment proposed by the TPO. Aggrieved, the taxpayer filed an appeal before Delhi Income Tax Appellate Tribunal ("ITAT").

Proceedings before ITAT

ITAT's Ruling

ITAT noted that the taxpayer was not charging any interest on the outstanding receivables from Non- AEs as well and also that the working capital adjustment undertaken by the taxpayer took into account the trade receivables outstanding as such during the year under consideration. ITAT further noted that for the earlier AY i.e. AY 2010-11, the same issue was decided by the coordinate bench of the Tribunal in the favour of the taxpayer.

ITAT relied on co-ordinate bench ruling in taxpayer's own case for the earlier AY (which was subsequently upheld by jurisdictional High Court) wherein it was held that the interest adjustment on the outstanding receivables is not warranted if the working capital adjustment takes into account the outstanding receivables. Therefore, ITAT held that *"in case the working capital adjustment properly takes into account the outstanding receivables, no additional imputation of interest on the same is warranted".*

With the view of the matter, ITAT remitted the issue back to the file of TPO for the verification of the fact, whether while making the working capital adjustment the outstanding receivables were taken into account or not. Thus, the appeal of the taxpayer was allowed for the statistical purpose.

NANGIA'S TAKE

The verdict in the instant case reiterates the fact that the results of the transfer pricing assessments should be consistent and not unnecessarily varied by the tax authorities unless there is a significant change in the business or international transactions undertaken by the taxpayer.

Source: Kusum Healthcare Private Limited [TS-65-ITAT-2018(DEL)-TP]

8. ITAT confirms TP adjustment deletion on royalty payment to the AE and rejects TPO's claim of 'no economic benefit'

Facts of the case

Bestexx MM India Pvt. Ltd. ("the taxpayer"), a subsidiary of Bestexx Kyoei Company Ltd. ("Associated Enterprise"/ "AE") is primarily engaged in the business of manufacturing of automotive components. The taxpayer has entered into various international transactions with its AE during the Assessment Year ("AY") 2009-10 ("the year under consideration"). During the year under consideration, the taxpayer paid royalty at the rate of 3.15% to its AE which has been paid for non-exclusive right of license to use the technology including the knowhow of its AE for the purpose of carrying out manufacturing of automotive components in India.

The taxpayer benchmarked the aforesaid transaction using Comparable Uncontrolled Price ("CUP") Method as the Most Appropriate Method ("MAM") considering the rate of royalties specified by the Central Government under FEMA regulations and rate prescribed by the Reserve Bank of India. However, the Transfer Pricing Officer ("TPO") held that no benefit had been received by the taxpayer for the use of technology & accordingly, computed the Arm's Length Price of the aforesaid transaction at NIL and proposed an adjustment thereof.

TPO observed that it is necessary to benchmark the international transaction of payment of royalty by applying *'benefit test'*. Under this test it is to be seen as to whether the taxpayer has received any tangible benefit from the use of the intangible which would help the taxpayer in earning greater economic benefit. Further, in arm's length situation the taxpayer would pay royalty only if the use of technology would give him greater economic benefit. However, in the present case, despite the use of intangible, the taxpayer has a loss at the net level.

In appeal, Commissioner of Income Tax (Appeals) ["CIT(A)"] after considering the entire material facts on record and the submissions made by the taxpayer including the additional evidences filed by the taxpayer as well as the remand report of the TPO, deleted the adjustment proposed by the TPO. Aggrieved by the order of CIT(A), Revenue filed an appeal before the Delhi Income Tax Appellate Tribunal ("ITAT").

Proceedings before ITAT
ITAT's Ruling

ITAT noted that the TPO without carrying out any analysis of the comparables, had solely held that ALP of royalty should be taken at NIL because the taxpayer has incurred loss at the entity level and therefore, no economic benefit has been obtained by the taxpayer for the technical knowhow from the AE. ITAT opined that *"Such a reasoning cannot be upheld at all, because once there is a valid agreement for transfer of non-exclusive right for use of license to use technology including knowhow of AE from which the taxpayer has earned substantial revenue receipts, then such a use of technology and knowhow is directly linked with manufacturing and resultantly sales"*. ITAT further held that *"Loss cannot be co-related with the economic benefit of use of technology or knowhow because profit and loss were market driven"*.

ITAT stated that the TPO was only required to check whether the royalty payment met ALP requirement or not and TPO failed to examine the same even when the chance was given to him in the remand proceedings by the CIT(A). ITAT concluded that CIT(A) had analyzed all the factors & various comparable uncontrolled transactions to reach to a conclusion that royalty payment @ 3.15% is at ALP and accordingly, there would be no reason to depart from such a finding. Hence, the appeal of the revenue was dismissed.

NANGIA'S TAKE

The verdict in the instant case reiterates the fact that even though the taxpayer has incurred losses at the entity level, it should not be construed by the tax authorities that no economic benefit has been obtained by the taxpayer for the use of technology including knowhow of its AE and accordingly, the tax authorities cannot make any adjustments without any logical basis.

Source: Bestexx MM India Pvt Ltd [TS-113-ITAT-2018(DEL)-TP]

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