ECONOMIC LAWS PRACTICE
ADVOCATES & SOLICITORS

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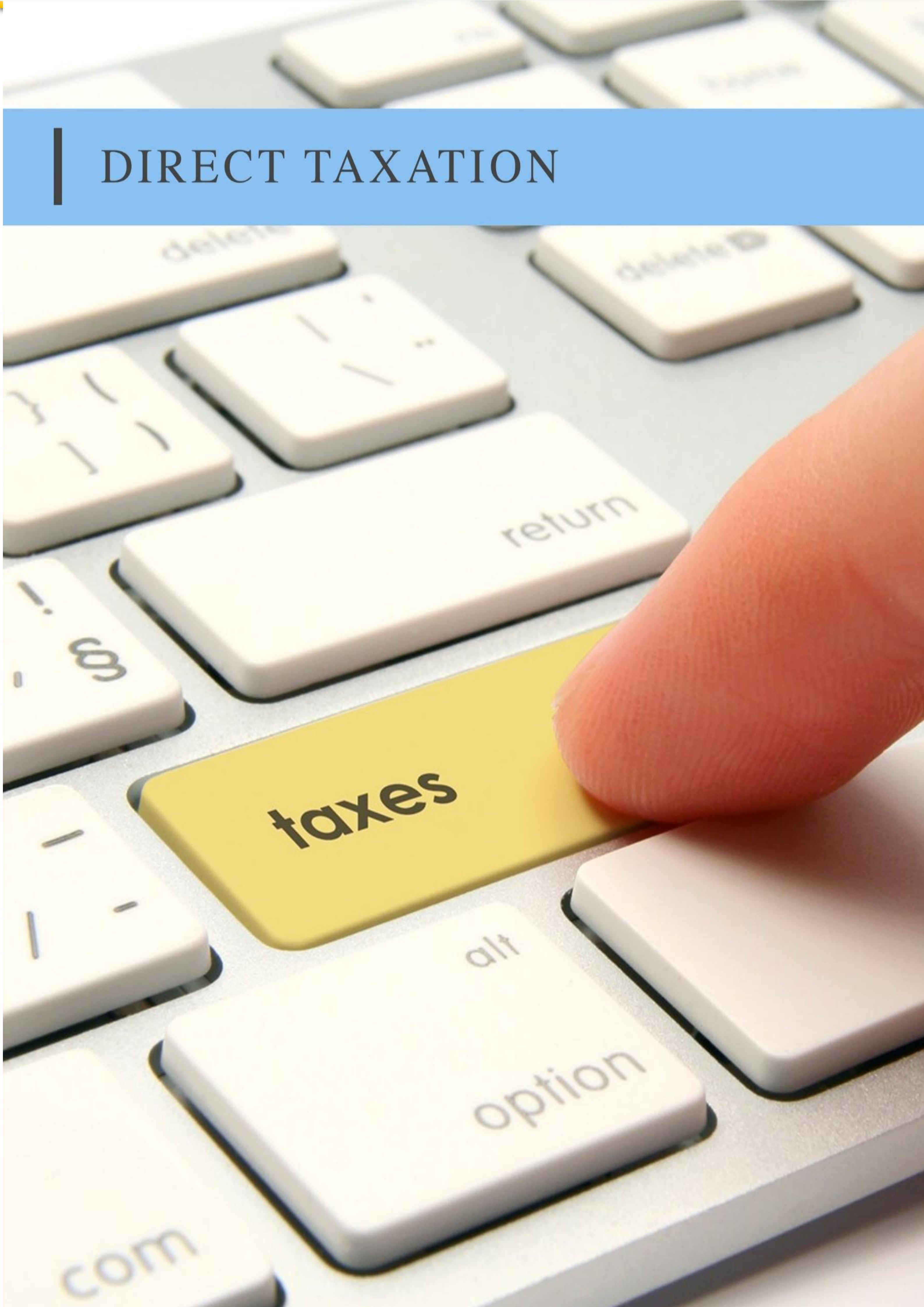
DIRECT TAXATION



RECENT CASE LAWS

Mehta Equities Ltd (ITA No. 5850/Mum/2019) (Mumbai ITAT)

Tax Officer's 'tax evasion' finding - a prerequisite for disallowing bonus payments to director-shareholders under Section 36(1)(ii)

FACTS OF THE CASE

- Taxpayer filed its Return of Income (**ROI**) for Assessment Year (**AY**) 2012-13 declaring total income of INR 52,72,893. The case was selected for scrutiny proceedings and assessment was completed under Section 143(3) of the Income tax Act, 1961 (**IT Act**) after making upward adjustments with respect to the following:
  - Disallowance under Section 14A read with Rule 8D(2)(iii) of the Income tax Rules, 1962 (**IT Rules**);
  - Disallowance of depreciation and motor car expenses;
  - Non-reconciliation of Annual Information Return (**AIR**);
  - Disallowance of expenses incurred for Long Term Capital Gains; and
  - Disallowance under Section 36(1)(ii).
- The Commissioner of Income tax (Appeals) (**CIT(A)**) granted relief on various issues except for the following:
  - Disallowance under Section 14A read with Rule 8D(2)(iii) of the IT Rules;
  - Non-reconciliation of AIR; and
  - Disallowance under Section 36(1)(ii).
- Aggrieved the taxpayer filed an appeal before the Income tax Appellate Tribunal (**ITAT**).

JUDGEMENT

- Disallowance under Section 14A read with Rule 8D(2)(iii) of the IT Rules
  - ITAT rejected the taxpayer's objection that the Tax Officer (**TO**) did not record his satisfaction before invoking Rule 8D; ITAT stated that the TO had categorically stated in the assessment order that the claim of the taxpayer in respect of expenditure in relation to exempt income was incorrect.
  - ITAT disallowed administrative expenses under Section 14A read with Rule 8D to the tune of INR 2.36 lakh as against exempt income earned of INR 3.99 lakh and remarked that '*This at glance is not in accordance with principles of proportionality.*' ITAT remitted the issue to the file of TO with a direction to the taxpayer for submitting the details of direct and indirect expenses incurred in incurring exempt income.
- Non-reconciliation of AIR
  - CIT(A) held against the taxpayer on the grounds that no material has been placed on record to substantiate that the interest income (difference between the interest income reflecting in AIR vis-vis credit to the profit and loss account) did not accrue to the taxpayer.
  - ITAT remitted the issue to the file of TO with a direction to examine the taxpayer's plea that the income reflected in AIR information was incorrect and it did not belong to the taxpayer.
- Disallowance under Section 36(1)(ii)
  - The TO, relying on the Special bench ruling in the case of ***Dalai Broacha Stock Broking Pvt Ltd (131 ITD 36)*** disallowed bonus paid in lieu of dividends under Section 36(1)(ii) of the IT Act. The aforesaid disallowance was upheld by the CIT(A), whereas ITAT highlighted that the aforesaid ruling was based on a categorical finding that the taxpayer there had adopted a tax evasion/tax avoidance scheme with quantification of the amount of tax evaded/avoided.

– ITAT thus held in order to invoke provisions of Section 36(1)(ii) of the IT Act based on the above special bench decision, the TO will have to provide a clear cut finding as to what was the tax avoidance or tax evasion involved, examine the amount of dividend which the taxpayer would have declared and compute tax sought to be evaded/ avoided by the taxpayer.

– Further, on TO's reliance on the Bombay High Court (**HC**) ruling in case of ***Loyal Motors Service Co Ltd (14 ITR 647)***, ITAT observed that the HC has actually allowed payment of bonus to the employee shareholders under Section 10(2)(x) of the erstwhile statute which is in *pari materia* to Section 36(1)(ii) of the IT Act.

– ITAT, relying on the Hon'ble Supreme Court (**SC**) judgment in case of ***Excel Industries Ltd (38 taxman 100)*** held that if the tax effect was revenue neutral, the proposition need not be disturbed. ITAT also relied on the Hon'ble SC ruling in ***Sun Engineering Work Pvt. Ltd (198 ITR 297)***, against TO's reliance on aforesaid Bombay HC ruling (***Loyal Motors (supra)***), wherein it was observed that quoting lines from the decisions dehorse its context is not permissible.

Augustus Capital PTE Ltd (ITA No. 8084/Del/2018) (Delhi ITAT)

Singaporean 'start-up' investment off-load to Snapdeal, non-taxable; Carveouts to 'indirect transfer' provision, retrospective

FACTS OF THE CASE

- Taxpayer, a Singapore based entity, was engaged in the business of incubation of companies i.e. providing new business, with necessary financial support and technical services. The taxpayer made an investment in another Singapore based entity i.e. Accelyst Pte Ltd (**foreign company**).
- During the year under consideration i.e. AY 2015-16, the taxpayer transferred its entire shareholding in Accelyst Pte Ltd to an Indian Company i.e. Jasper Infotech Pvt Ltd (**JIPL**). JIPL withheld taxes at the rate of 43.26% on the entire sale consideration.
- The taxpayer contended before the TO that in view of the amended provisions of Section 9(1)(i) read with Explanation 5, 6 and 7, the transaction involving the sale of shares of foreign company, which held investment in India was not taxable.
- The TO rejected taxpayer's contention and held that Explanation 7 to Section 9(1)(i) was inserted by the Finance Act, 2015 with effect from April 1, 2016. The Explanation was prospective in nature and was not applicable for AY under consideration i.e. AY 2015-16. Accordingly, the TO computed long term capital gains arising from the transfer of shares of the foreign company. The aforesaid addition was upheld by Dispute Resolution Panel (**DRP**).
- The present appeal was filed by the taxpayer against the order of DRP before the ITAT.

JUDGEMENT

- ITAT noted that Section 9(1)(i) of the IT Act was amended to obviate the decision of the Hon'ble SC in case of ***Vodafone International Holdings B.V (341 ITR 1)***. Explanation 5 to Section 9(1)(i) of the IT Act was introduced by Finance Act 2012 with retrospective effect from April 1, 1962. Shome Committee was constituted due to the apprehensions and ambiguities in Explanation 5. Explanations 6 and 7 were inserted by the Finance Act, 2015 pursuant to the recommendations of Shome Committee.
- Before the recommendation of Shome Committee could be accepted by the Government, the Delhi HC in case of ***Copal Market Research Limited (49 Taxmann.com 125)*** held that transfer of shares of an overseas company that derived less than 50% of its value from the assets situated in India could not be held as taxable in India. ITAT remarked that pursuant to the ruling in Copal Market Research (*supra*), the IT Act was amended to insert Explanation 6 and 7.
- ITAT also took note of Central Board of Direct Taxes (**CBDT**) Circular 41 of 2016 (FAQs on Indirect Transfer) and the Explanatory Notes to Finance Act, 2015.

- ITAT noted that both Explanations 6 and 7 start with 'For the purposes of this clause' and Explanation 5 starts with 'For removal of doubts' in relation to Section 9(1)(i). It thus, opined that Explanations 6 and 7 have to be read with Explanation 5 to understand the provisions of Section 9(1)(i) of the IT Act.
- ITAT held that since Explanation 5 has been given retrospective effect and Explanations 6 and 7 have been inserted in furtherance of the object of insertion of Explanation 5, these two Explanations cannot be read in isolation, but have to be tagged along with Explanation 5 so that both the Explanations can be given a retrospective effect, in view of Hon'ble Delhi HC judgment in case of ***Copal Market Research (supra)***.
- ITAT thus directed the TO to read Explanation 7 as applicable for the year under consideration and delete the impugned additions.

Marg Limited (Tax Appeal no. 41 to 43 & 220 of 2017) (Madras HC)

Disallowance under Section 14A cannot exceed exempt income; Rejects revenue's 'hypothetical' future income plea

FACTS OF THE CASE

- The ITAT upheld enhanced disallowance made by the TO under Section 14A read with Rule 8D of the IT Rules, disregarding that the taxpayer had voluntarily made disallowance (in excess of dividend income earned) under Section 14A of the IT Act. Aggrieved, the taxpayer is in the appeal before the HC for four AY's i.e. from AY 2009-10 to AY 2012-13.
- The question of law raised before the HC was that whether disallowance of expenditure incurred in excess of the exempt income was justified.

JUDGEMENT

- HC relied on upon various decisions of HCs and observed that it is a settled position in law that the disallowance of expenditure incurred to earn exempt income under Section 14A of the IT Act, cannot exceed such exempt income itself during the relevant AY.
- HC observed and remarked that the position of law was crystal clear that without recording satisfaction by the TO, the expenditure incurred to earn exempt income, as computed by the taxpayer was not acceptable for specified reason, the TO cannot resort to compute disallowance under Rule 8D. The ITAT however took a view contrary to the legal position and upheld the disallowance.
- HC noted that the TO has to mandatorily record his satisfaction with regard to the proportionate disallowance of expenditure under Section 14A of the IT Act as made by the taxpayer and that it was dissatisfied for such cogent reasons as specified and hence, was liable to be rejected.
- HC stated that the reach of computation provision, namely Rule 8D cannot be read beyond the parent provision of Section 14A itself, which itself is not a charging provision, but a restriction on allowance of expenditure incurred to earn exempted income. HC observed that merely to make more disallowances and impose tax on the hypothetical income of the taxpayer, in contrast to the concept of 'real income' to be taxed as per Section 5 of the IT Act, the TO under the IT Act has adopted such absurd procedures.
- ITAT rejected TO's contention that the taxpayer's strategic investment would yield high dividends in future when no expenditure might be incurred, hence a larger disallowance under Rule 8D should be allowed. HC stated that the disallowance of expenditure incurred for the year in question can only be considered under Section 14A of the IT Act and no such hypothetical earning in future as against no expenditure incurred for that, was envisaged under Section 14A of the IT Act.
- HC remarked that the nature of investment had nothing to do with Section 14A of the IT Act. It was exempt income in the form of dividend which forms the cap or roof limit for disallowance. If no dividend income was declared by the investee company or subsidiary company as the case may be, the disallowance computed under Rule 8D cannot be taxed as a 'hypothetical income' of the taxpayer(by providing a negative figure beyond the

dividend income earned during that year, to be added to the taxable income of the taxpayer). That will make the mockery of the concept of 'real income' of the taxpayer being taxed and it was the bedrock of the IT Act itself.

- HC held that average disallowance as computed under Rule 8D could be disallowed only if the taxpayer had actually earned dividend income in excess of such amount disallowed, that too, after recording reasons for rejecting the apportionment of expenditure so incurred or claim that no such expenditure was incurred to earn that much of dividend income.
- HC even rejected larger disallowance proposed by the taxpayer voluntarily in the computation of disallowance under Rule 8D, relied on Karnataka HC decision in case of ***Pragati Krishna Gramin Bank (95 taxmann.com 41)***.

Giesecke & Devrient (India) Pvt Ltd (ITA no. 7075/Del/2017) (Delhi ITAT)

Beneficial Double Taxation Avoidance Agreement (DTAA) rate on dividends prevails over Dividend Distribution Tax (DDT) rate; Allows additional ground

FACTS OF THE CASE

- Taxpayer, an Indian company, is a wholly owned subsidiary of a German company (**G Co**) and was engaged in the business of trading of currency verification and processing systems.
- The taxpayer paid dividends to G Co and discharged DDT liability under the IT Act. DDT, for the year under consideration i.e., AY 2012-13, was levied at the rate of 16.22%, whereas as per the Germany DTAA the withholding tax rate on dividend income is 10%.
- During the appeal proceedings before the ITAT, the Taxpayer raised an additional ground of appeal (amongst other existing issues of transfer pricing, expense disallowance etc.) and contended that the TO failed to appreciate that the dividend income was of non-resident shareholder (G Co), who is governed by the provisions of the India Germany DTAA. Accordingly, DDT rate under the IT Act needs to be restricted to the rate specified under the India Germany DTAA and any excess DDT should be refunded.

JUDGEMENT

- Relying upon the Delhi ITAT decision in case of ***Maruti Suzuki India Ltd 961/Del/2014*** (affirmed by Delhi HC), ITAT admitted additional ground raised by the taxpayer with respect to dividend taxability.
- The moot question which required adjudication was whether the DDT levied in terms of Section 115-O of the IT Act should be restricted to the rate of tax on dividends as provided under the applicable DTAA governing non-resident shareholders.
- Relying on Bombay HC judgment in case of ***Godrej and Boyce Manufacturing Company Limited (328 ITR 81)***, ITAT held that DDT is tax on the company and not on the shareholder. ITAT thereafter observed that DDT levied under Section 115-O is a tax on income and definition of income includes dividend. Reliance was placed on Memorandum to Finance Bill 1997 and 2003 to conclude that DDT was levied on the company as administrative convenience but levy for all intent and purpose is the charge on the dividend.
- ITAT also considered economic considerations and observed that, the burden of DDT falls on the shareholders rather than on the company, as the amount of distributed profits available for shareholders stands reduced to the extent of DDT levied.
- ITAT remarked that under the IT Rules, details regarding payment of DDT is required to be provided in the Income Tax return form and have to be disclosed in the Tax Audit Return (Form 3CD). ITAT observed that the IT Act does not provide for a separate adjudication/passing of separate order to adjudication of liability on DDT. The Income tax assessment order read with income tax computation form quantifies the DDT liability. Section 115-Q of the IT Act merely provides for the consequences of non-payment of DDT, but there is no separate/specific provision in the IT Act for collection and recovery of DDT in default.

- ITAT analyzed that the provisions of Sections 4 and Section 5 are subject to the provisions of Section 90 that provides for a beneficial treaty regime. ITAT relied upon the rulings of the Hon'ble SC in ***Azadi Bachao Andolan (263 ITR 706)***, Andhra Pradesh HC decision in case of ***Visakhapatnam Port Trust (144 ITR 46)*** and Calcutta HC decision in case of ***Devi Ashmore India Ltd (190 ITR 626)*** to observe that in case of inconsistency between the DTAA and the IT Act, the DTAA shall prevail over the IT Act.
- ITAT observed that under the Memorandum to Finance Bill 2020, it has been specifically mentioned that the incidence of tax is on the payer company and not on the recipient where it should normally be. This is because the dividend is income in the hands of the shareholders and not in the hands of the company. The incidence of tax should, therefore, be on the recipient.
- ITAT found the flat rate of DDT as 'iniquitous and regressive' where the recipient was taxable at a lower rate. ITAT thus held that a conjoint reading of the Memorandum to Finance Bill 1997, 2003 and 2020 would show that levy of DDT was merely for administrative conveniences and withdrawal of DDT was in lieu of the fact that revenue was across-the-board, irrespective of marginal rate, at which recipient is otherwise taxed.
- Further, ITAT held that the liability to DDT under the IT Act which falls on the company was not relevant when considering applicability of rates of dividend set out in the DTAA. ITAT observed that the India- Germany DTAA was notified on November 29, 1996 and Section 115-O was inserted vide the Finance Bill, 1997 (after the notification of India-Germany DTAA).
- ITAT considered the observations of the Delhi HC in the case of ***New Skies Satellites (2016) [TS-5188-HC-2016(DELHI)-O] (Del)*** wherein the Court held that no amendment to the IT Act, whether retrospective or prospective can be read in a manner so as to extend its operation to the provisions of the DTAA. Further, the Delhi HC held that the amendments to domestic law cannot be read into treaty provisions without amending the treaty itself.
- Based on the above, the ITAT held that tax rates specified under the India-Germany DTAA in respect of dividend must prevail over rate of DDT under Section 115-O of the IT Act.
- Additionally, the ITAT also made an observation that the tax rate of 10% under Article 10(2) of the India-Germany DTAA was not applicable if the beneficial owner of the dividend carries on business in another state through a Permanent Establishment. It remanded the matter to the file of TO for verification on this limited point.

Sahayamatha Salterns (ITA no. 1498/Chny/2019) (Chennai ITAT)

Upholds revision under Section 263 for on-money payment probe, though not falling under 'limited scrutiny' ambit

FACTS OF THE CASE

- The taxpayer, a company incorporated under the provisions of Companies Act, 1956, was engaged in the business of salt production and trading. The taxpayer filed its ROI for AY 2014-15 declaring total income of INR 63,15,640 as against income assessed of INR 869,88,850 under Section 143(3) of the IT Act.
- While the assessment was completed after due verification, the Principal Commissioner of Income tax (**PCIT**) had opined that the TO ought to have considered the information received from the Deputy Commissioner of Income tax during the course of scrutiny proceedings on-money payment for land-purchase. The TO however failed to do so, which rendered the assessment order erroneous and prejudicial to the interests of the revenue. Accordingly, the order was set aside. Aggrieved by the order, the taxpayer is in appeal before the ITAT.

JUDGEMENT

- The only issue that required adjudication in the impugned appeal is related to the validity of power of revision exercised by the PCIT under Section 263 of the IT Act.

- The taxpayer, relying on CBDT instruction no. 20/2015 dated December 29, 2015 and 6/2017 dated July 21, 2017 and co-ordinate bench ruling in case of ***Smt Padmavathi (ITA no.1306/Chny/2019)*** contended before the ITAT that assessment was completed based on limited scrutiny and the TO cannot go beyond the issue for which the case was selected for scrutiny assessment. On the contrary, the TO, placing reliance on the order of lower authorities argued that the Circulars give liberty to the TO to consider any other items which would come to the notice during the assessment proceedings.
- ITAT referred to clause 3(d) of the said CBDT instruction no. 20/2015 and remarked that considering the exception clause carved in this clause, the TO should have sought permission from the PCIT to enquire into this issue of assessing the payment of on-money consideration at the time of purchase of land.
- ITAT thus held that not following procedure prescribed in the said exception clause would render the assessment order erroneous and prejudicial to the interests of the Revenue. It thereby confirms the jurisdiction of PCIT under Section 263 of the IT Act. Here the ITAT relied on Patna HC decision in case of ***Pushpa Devi (164 ITR 639)***.
- With respect to reliance on co-ordinate bench ruling in Padmavathi (supra), ITAT clarified that the ITAT had rendered the decision overlooking the exceptional clause and thus, the decision was per-incuriam i.e. has no precedential value.

Head Infotech India Pvt. Ltd [ITA No. 2372/HYD/2018) (Hyderabad ITAT)

Service charges retained by payment gateways is not commission under Section 194H

FACTS OF THE CASE

- The taxpayer is in the business of developing and running an online game on its own web portal www.ace2three.com. During the year, the TO observed that the taxpayer had debited an amount under the head 'payment to Gateways'.
- The taxpayer contended that the amount paid represents aggregate of the service charges retained by the Gateways from the amounts paid by the customers for enabling them to play online games in the taxpayer's portal. The taxpayer submitted that the terms and conditions under which the Gateway has rendered services to the customers were invariably recorded in the agreements between the taxpayer and the respective Gateways, which establish that the taxpayer and Gateways were independent parties in their respective fields and therefore, there was no necessity of deducting tax deducted at source (**TDS**) under Section 194H of the IT Act.
- However, the TO was not convinced with the taxpayer's submissions and held that the amount retained by the Gateways is commission paid by the taxpayer to such Gateways and the taxpayer was required to deduct TDS @30%.
- Aggrieved, the taxpayer preferred an appeal before the CIT(A), who deleted the disallowance made by the TO under Section 40(a)(ia) of the IT Act. The TO has preferred the present appeal before the ITAT.

JUDGEMENT

- The ITAT held that the CIT(A) has followed the decisions of the coordinate benches of the ITAT wherein it has been held that 'sale made on the basis of a credit card' is the transaction of the merchant establishment and that the credit company only facilitates the electronic payment for a certain charge and the commission retained by the credit card company is therefore in the nature of normal banking charges and not in the nature of commission/brokerage for acting on behalf of the merchant establishment.
- Further, the ITAT also noticed that the Gateways have offered the income to tax in their hands while filing their ROI. Therefore, the proviso to Section 40(a)(ia) of the IT Act is applicable and for this reason also, the disallowance made by the TO was not sustained by the ITAT.

Mitsui & Co. Ltd [ITA No. 4764/Del/2016) (Delhi ITAT)

Mitsui's Indian Subsidiary does not constitute Dependent Agency PE (DAPE) in India

FACTS OF THE CASE

- The taxpayer is a company incorporated in Japan and is one of biggest trading houses of the world. During the year, the TO noticed that the taxpayer has three project offices in India namely; TISCO, Purulia, Teesta Projects. The TO noticed that the taxpayer had entered into contracts with various parties involving supply of designs, drawings, manufacturing, erection and commissioning projects.
- The taxpayer submitted that no income has been earned from the execution of these projects and income is from offshore supplies accrued outside India and no operation has been carried out in India in respect of offshore supplies. However, the TO held that the Indian entity of the taxpayer constituted DAPE of the taxpayer in India.
- Accordingly, the TO by applying the gross profit margin of 2.07% to the total supplies made by taxpayer to Indian customers made an addition of 50% of such amount as profit attributable to the DAPE in India.
- The CIT(A) upheld the view of the TO that the Indian entity constituted DAPE of the taxpayer in India. However, the CIT(A) limited the attribution to 20% of such gross trading profit. Aggrieved by the order of the CIT(A), the TO filed an appeal before the ITAT. Further, the taxpayer also filed cross objections before the ITAT challenging the constitution of DAPE of the taxpayer in India.

JUDGEMENT

- The ITAT observed that the issue stands squarely covered in favour of the taxpayer by the decision of the ITAT in taxpayer's own case for previous year, wherein it was held that the Indian entity did not constitute DAPE of the taxpayer in India.
- In that order, the ITAT had pointed out that it was not the case of the TO that the Indian entity habitually exercised authority to conclude contracts or habitually maintained a stock of goods or merchandise. The only contention of the TO was that commission was paid by the taxpayer to the Indian entity, basis which the TO assumed that the Indian entity secured orders in India.
- However, the ITAT had rejected the contention of the TO and it observed that the Indian entity was supposed to put best efforts to collect information with regards to the project to find the best candidate, to attend/take care of the visitors from Japan and to analyze the feasibility report.
- The ITAT confirmed the taxpayer's contention that the Indian entity was only providing support services and it was not securing orders on behalf of taxpayer company.
- The ITAT had also examined the TP study report to arrive at the Functional and economic analysis of the transactions which was confirmed by the Transfer Pricing Officer (**TPO**) that services of the Indian entity were in the nature of support services similar to the activities of a liaison offices. The ITAT held that none of the conditions prescribed in Article 5(7) of the India-Japan DTAA were fulfilled and accordingly, the Indian entity of the taxpayer did not constitute DAPE in India.
- In view of the above, following the consistent decisions of the ITAT in taxpayer's own case in the preceding AYs and in absence of any contrary material brought on record, the ITAT held that the Indian entity did not constitute DAPE of the taxpayer in India and accordingly, rejected the appeal of the TO.

MUFG Bank Ltd [ITA No. 7895/Del/2019) (Delhi ITAT)

HO expense under Section 44C denied against interest income which was taxed on gross basis under India-Japan DTA

FACTS OF THE CASE

- The taxpayer being a banking company, is a tax resident of Japan and is engaged in wholesale banking operations in India through its branch office under a license from the Reserve Bank of India (**RBI**) and is covered by The Banking Regulation Act, 1949. The primary activities of the taxpayer are that of administration and management of banking and other financial services provided by its group companies.
- During the year, the taxpayer had received interest from External Commercial Borrowing (**ECB**) loan given by the Head Office/overseas branches to various customers in India. The TO taxed this income @10% on gross basis as per Article 11(2) of the India-Japan DTAA. Against the said income, the taxpayer had claimed deduction under Section 44C of the IT Act.
- The TO held that since interest on ECB loans is taxed on a gross basis, therefore there is no question of allowing any deduction from such income and accordingly, did not consider the interest on ECB loans for the purpose of computing deduction under Section 44C of the IT Act.
- The said disallowance was confirmed by the DRP. Aggrieved by the order of the DRP, the taxpayer has filed an appeal before the ITAT.

JUDGEMENT

- As per Section 44C of the IT Act, non-residents carrying on any business or profession in India through its branches are entitled to a standard deduction of 5% of the 'Adjusted Total Income' in respect of general administrative expenses incurred by the foreign head office insofar as such expenses can be related to the business or profession in India. Further, the 'Adjusted Total Income' is defined to mean the total income computed in accordance with the provisions of the IT Act.
- The ITAT observed that in the present case, interest income on ECB loans is not computed under the head 'Profits and Gains of Business or Profession' as provided under Section 28 to Section 43A of the IT Act, but was taxed under Article 11(2) of the India-Japan DTAA on a gross basis @10%.
- Further, the ITAT stated that it is the option of the taxpayer to be governed by the provision of the DTAA or domestic tax Laws, whichever is more beneficial, but there is no mandate that taxpayer can opt for lower taxes as per DTAA and claim expenses as per domestic tax laws. It was noted that this will dilute the amount of tax payable on interest income in the source country as payable according to the DTAA.
- The ITAT also noted that there is no mandate in the DTAA to grant any such deduction from income taxed under Article 11(2) of the DTAA.
- Accordingly, the ITAT held that it did not find any infirmity in the order of the TO in not granting deduction under Section 44C of the IT Act from the above income which is taxed under Article 11(2) of the India-Japan DTAA on a gross basis.

Danisco India Pvt. Ltd (ITA No.2846/Del/2016) (Delhi ITAT)

ITAT rejects TPO's Arms' length price (ALP) determination and benefit test, establishes availment of management-services from AE

FACTS OF THE CASE

- The taxpayer was a closely held company incorporated in India and majority shares of the taxpayer were held by Danisco A/S Denmark. The taxpayer was engaged in various activities and had entered into several international transactions with its Associated Enterprises (**AEs**).
- The TO made reference under Section 92CA(1) of the IT Act to the TPO and the TPO challenged the Intra Group Services (**IGS**) availed by the taxpayer. The taxpayer explained that it had paid service fee under the head

'management services' for availing certain services from the group companies and the services were utilized in its operations and served as its business tool for running the business. Documentary evidence for availment of services were also filed on a sample basis before the TPO.

- The taxpayer also explained that due to continued services received by it, the turnover had increased over a period of years. The taxpayer also pointed out that it had conducted benchmarking analysis for the IGS as part of its transfer pricing documentation.
- The TO disallowed the management service fee and the taxpayer preferred an appeal before the CIT(A) against this and subsequently before the ITAT. The following issues arose, before the ITAT:
  - If the services have been availed by it and they are connected to the main activities, then whether availment of services is to be benchmarked on a standalone basis as against being aggregated with the other international transactions undertaken by the taxpayer;
  - Jurisdiction of the TPO for benchmarking the international transaction to determine the benefit derived by the taxpayer out of services availed and whether or not the taxpayer has availed the said services.

JUDGEMENT

- The ITAT allowed taxpayer's appeal against TP adjustment made on account of payment of management services and held that TPO exceeded his jurisdiction in holding the value of such international transaction to be Nil. Taking note of the evidences produced by the taxpayer, the ITAT observed that the taxpayer availed specialized services provided by AEs from the common pool and that the services were charged on a cost to cost basis applying a suitable allocation key. Thus, the ITAT found no merit in TO's order in questioning the availment of services and the benefit derived by the taxpayer.
- The ITAT also stated that the TPO's finding of duplication of services and the subsequent finding of CIT(A) that the activity was that of shareholder activity, establish the availment of services. The TO/TPO cannot sit in judgment over the manner in which businesses have to be carried on by the businessman. The domain of the TPO is limited to check whether services have been availed. Further, the ITAT held that the payment made by the taxpayer being cost to cost reimbursement of the services availed from the common pool is duly allowable as a business expenditure in the hands of the taxpayer.
- In this regard, reliance was placed by the ITAT on jurisdictional HC's ruling in ***EKL Appliances Ltd (345 ITR 241)*** wherein it was held that benchmarking of cost to cost reimbursement of expenses was not within TPO's jurisdiction while computing ALP of the international transaction under Section 92CA of the IT Act.

PT.LP Display Indonesia (ITA Nos.1845 to 1847/Del/2014) (Delhi ITAT)

Given that the arm's length principle is satisfied, the ITAT quashes re-assessment initiated on the premise of PE-existence

FACTS OF THE CASE

- L.G. Electronics India Pvt. Ltd. (**LGEIL**) is a company incorporated in India. LGEIL undertook various international transactions with its AE's.
- A TDS survey under Section 133A of the IT Act was conducted at the premises of LGEIL. The purpose of the survey on LGEIL was to ascertain whether TDS compliances were being made on payments made by LGEIL to its AEs for purchase of raw-material, capital goods etc.
- During the course of survey, statement of employees, both Indian and expatriates were recorded and on the basis of the said statement, the TO concluded that the AEs including the parent company i.e. L.G. Korea had a PE in the form of LGEIL in India.

- Consequent thereto, re-assessment notices under Section 148 of the IT Act were issued to non-resident AEs for various AYs on the basis of the following allegations:
  - The allegation of the TO was that L.G. Korea and its AEs (including PT.LP Display Indonesia i.e., the taxpayer) had business connection as per Section 9(1)(i) of the IT Act in India with LGEIL; and
  - The taxpayer was carrying on business with LGEIL through fixed place permanent establishment (**PE**) as per Article 5(1) of the India-Indonesia DTAA.
- Further, the TO noted that the taxpayer was a foreign company and had not filed its ROI for the year under consideration. The details of the transactions as per Form No.3CEB of LGEIL were referred i.e. export of raw material and finished goods and it was established that the taxpayer had business connection as well as PE in India.
- Aggrieved by the above, the taxpayer preferred an appeal before the DRP and subsequently before the ITAT.

JUDGEMENT

- The ITAT observed that Hon'ble SC in ***Honda Motors Co. Ltd. [2018] 92 taxmann.com 353*** (SC) held that once the international transactions were held to be at ALP, even if there was a PE in India, no profit could be attributed to it. Further, the ITAT observed that the Hon'ble SC in case of ***L.G. Group Companies (Civil Appeal No(S). 781 of 2018 & Ors.)*** noted that the DRP found that there is no PE in India and consequently the TO was directed to pass orders dropping the proceedings.
- Applying the ratio laid down by the Hon'ble SC in L.G. Group of companies and Honda Motors Co. Ltd (*supra*), wherein it has been held that since the DRP has given the finding that the taxpayer and other AEs of LGEIL do not have a PE in India; the basis for initiating the re-assessment proceedings fail and the same are held to be infructuous.
- In view of the above observations, the ITAT quashed the reassessment proceedings under Section 147 of the IT Act on the premise that if the international transactions are found to be at ALP then the entire question of PE becomes academic and there is no merit in the re-assessment proceedings initiated under Section 147 of the IT Act.

NOTIFICATIONS

CBDT notifies tolerance limit under transfer pricing for AY 2020-21

- In pursuance of third proviso to Section 92C(2) of the IT Act read with proviso to sub-rule (7) of Rule 10CA of the IT Rules, the Central Government has notified that where the variation between the ALP determined under Section 92C of the IT Act and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one percent of the latter in respect of wholesale trading and three percent of the latter in all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the ALP for AY 2020-21.

CBDT notifies the Equalization levy (Amendment) Rules, 2020 to give effect to EL 2.0 provisions

- Equalisation Levy Rules, 2016 (**EL rules**) were notified by the CBDT on May 27, 2016 which provided the manner of payment of equalisation levy (**EL**), form for furnishing annual statement of specified services, forms for filing an appeal before the appellate authorities etc.
- In order to implement the amendment introduced by Finance Act, 2020 with respect to consideration received/receivable by non-resident e-commerce operators for e-commerce supply or services provided to

specified persons, the existing EL rules and accompanying forms have been modified and the same is notified by the CBDT on October 28, 2020.

CBDT extends tax-audit, return filing due-dates till December 31st , January 31st respectively

- CBDT vide press release dated October 24, 2020 has further extended the due dates as below:

Sr. No.	Particulars	Old date	Revised due date
A	Return filing due date for Financial Year (**FY**) 2019-20 in respect of taxpayers who are required to get their accounts audited (including their partners) and furnish a tax audit report	October 31, 2020	January 31, 2021
B	Return filing due date for FY 2019-20 in respect of taxpayers who are required to furnish report in respect of international/specified domestic transactions	November 30, 2020	January 31, 2021
C	Return filing due date for FY 2019-20 in respect of other taxpayers	July 31, 2020	December 31, 2020
D	Date of furnishing audit reports including tax audit report and report in respect of international/specified domestic transactions report for FY 2019-20	September 30/ October 31 (as the case may be)	December 31, 2020
E	Due date for payment of self-assessment tax for taxpayers whose self-assessment tax liability is up to Rs. 1 lakh	November 30, 2020	January 31, 2021 (point A, B above) December 31, 2020 (point C mentioned above)

Government notified declaration cut-off date under Vivad se Vishwas Act, also extends payment timeline till March 31, 2021 and clarification of CBDT on requirement of 'payment within 15 days' under Vivad se Vishwas Scheme

- CBDT vide Notification No. 85/2020 dated October 27, 2020 provided sunset date of December 31, 2020 for filing of declaration under Vivad Se Vishwas Act, 2020. Furthermore, the Notification provided extension of time limits for payment under the scheme at 100% of disputed tax by March 31, 2021, with additional amount of 10% on or after April 1, 2021, but before a date which is yet to be notified.

- CBDT vide Circular 18 of 2020 dated October 28, 2020, clarified that where the declarant files a declaration on or not before December 31, 2020, the designated authority while issuing the certificate shall allow the declarant to make payment without additional amount on or before March 31, 2021.

CBDT issued stringent guidelines for coercive/intrusive tax recovery

- CBDT vide order dated October 16, 2020 issued guidelines, for TO or Tax Recovery Officer, who are authorized to carry out function related to recovery of arrear or current tax demand as per the provisions of IT Act. The revised guidelines come into effect immediately.

NEWS

- **Discretionary personal hearing under Faceless Appeals scheme faces Constitutional face-off**

  – Delhi HC issued notice to the TO in a writ petition seeking grant of 'personal' virtual hearing to all taxpayers under the Faceless Appeals Scheme, 2020. The taxpayer highlighted that in terms of the Scheme, even the right to opportunity of being heard virtually is at the discretion of the the Chief Commissioner or the Director General.

  – The taxpayer prayed that Faceless Appeal Scheme, 2020 be declared discriminatory, arbitrary, and illegal to the extent it subjects virtual hearing to the approval of the senior authorities under the IT Act. The matter is listed for hearing on December 15, 2020.

INDIRECT TAXATION

RECENT CASE LAWS

Assistant Commissioner of CGST and Central Excise vs Sutherland Global Services (P) Limited [WRIT APPEAL NO 53 OF 2020]

Disallowed transition of Education Cess (EC), Secondary and Higher Education Cess (SHEC) and Krishi Kalyan Cess (KKC) into GST

FACTS OF THE CASE

- Respondent is engaged in providing Information Technology enabled Services to customers worldwide. A writ petition was filed by the Respondent before Single Bench of Madras High Court to allow transition of credit of EC, SHEC and KKC. Hon'ble Single Bench allowed transition of such credits.
- Subsequently, Revenue preferred an appeal against the order of Single Judge. The issue for consideration was whether Respondent is entitled to utilise unutilised credit of EC, SHEC and KKC, (jointly referred to as the **Cesses**) to discharge output GST Liability upon introduction of GST regime.
- The Respondent put forth the following arguments:
  - At the outset, transition of such credit should be eligible under Section 140(1). Separately, Respondent had obtained centralized registration under the service tax regime and thus, transition of Cesses should also be eligible in terms of Section 140(8) of the CGST Act;
  - Amendment to Section 140(1) by insertion of words 'of eligible duties' in Section 140(1) should not affect application of Section 140(8) of the CGST Act, as no such similar insertions was made in Section 140(8). Each sub-section of Section 140 is a separate bucket and it is incorrect to read the expression 'eligible duties' into all sub-sections;
  - It was also argued that basis various decisions, Cess which is deposited into the Consolidated Fund of India amounts to a tax/ duty and should thus be covered within the phrase 'eligible duties' in Section 140(1)
  - No provision was enacted to lapse the credit pertaining to EC and SHEC, therefore, in absence of explicit provision to this effect, availment of Cesses and reflection of the same in the returns should be construed as valid credit. Relying on various Supreme Court rulings, it was argued that credit once availed becomes a vested right.

JUDGEMENT

- Hon'ble Division Bench held that in view of express explanations provided in Section 140, transition of Cesses should not be eligible under Section 140(1). It was further observed that Explanation 3, which disallows transition of any kind of Cess, should equally apply to Section 140(8). Explanation 3 has its own force and application and does not have a limited application in cases wherein Explanation 1 and Explanation 2 apply.
- 'Taking' of input credit of Cesses in electronic ledger after 2015, after the levy of Cess itself ceased, does not even permit such Cess to be called a CENVAT Credit. Therefore, mere accounting entry will not give any vested right to claim such transition and set off against such output GST liability.
- It was further observed that Cesses were not subsumed in the GST regime, either by Parliament or States and thus, question of transitioning to GST regime cannot arise.
- Basis this, it was held that Respondent is not entitled to carry forward and set off of unutilised EC, SHEC and KKC against the GST output liability under Section 140 of the CGST Act.

RECENT ADVANCE RULINGS

ICU Medical India LLP[Order No 23 / ARA / 2020]

Applicability of GST on reimbursement to Foreign Holding Company

FACTS OF THE CASE

- Applicant is engaged in the business of software development for its ultimate Holding Company, ICU Medical Inc. (ICU Inc.) located in USA. ICU Inc. entered into an agreement with Wells Fargo Bank, located in USA to provide a Credit Card to the employees of ICU Inc. and its subsidiaries located globally for official usage.
- Employees of the Applicant also received credit card issued by Wells Fargo Bank, *albeit* the Applicant does not have any contract with bank or ICU, Inc. for the same.
- ICU Inc. settles the monthly credit card liability with Wells Fargo Bank for all locations globally. Subsequently, an invoice is raised by ICU Inc. on the Applicant for the credit card liability relating to its employees. Applicant reimburses such amount to ICU Inc. at actual. An application was filed before AAR seeking clarification on following:
  - Whether GST is applicable on reimbursement of expenses to the ultimate Holding company?
  - In case GST is leviable, is rate of GST applicable on the same?

RULING

- AAR held that ICU Inc., is supplying credit card services to the Applicant for specific use to its employees for travel, accommodation, meals etc. for the purpose of business.
- For the privilege of using these cards, Applicant has to pay ICU Medical Inc. all the relevant expenses and charges made by its employees.
- In view of this, instant transaction qualifies as supply of service for a consideration and Applicant should be liable to discharge GST under the reverse charge mechanism.

M/s Karnataka State Electronics Development Corporation Limited[Order No KAR/ AAAR-04/ 2020-21]

Applicable rate of GST on 'Street lighting activity' undertaken under 'Energy Performance Contract'

FACTS OF THE CASE

- Appellant, a Karnataka State Government Entity, has entered into an Energy Performance Contract (**ESCO**) with the Thane Municipal Corporation (**TMC**). Under this contract, Appellant will undertake activity of installing, maintaining, etc of street lighting and revenue will be earned on shared saving model.
- Pursuant to application made to Authority for Advance Ruling (**AAR**), it was clarified that street lighting activity, under ESCO contract amounts, qualifies as a composite supply, principal supply being supply of goods and applicable GST rate should be 12%. AAR further clarified that Appellant was not eligible for exemption under entry 3 or 3A of Notification No 12/ 2017 – Central Tax (Rate) dated June 28, 2017, as impugned supply was not a pure service contract. Appellant has preferred an appeal against the order of AAR.

RULING

- Appellate Authority for Advance Ruling (**AAAR**), while setting aside the order of AAR, observed that the essence of ESCO contract is operation, management and maintenance of the street lighting system. LED lights and other equipment are merely goods used for rendering the service.
- Basis this, it was held that predominant supply is that of supply of service and GST should be applicable at the rate of 18% on the contract.

- On Appellant's claim that contract is for rendering pure service to TMC and thus, benefit of exemption under Entry 3 of Notification No 12 should be available, AAAR observed that the instant contract is not a pure service contract since contract also involves supply of goods. Further, since the Appellant failed to demonstrate that value of goods component is less than 25% of the contract value, the benefit of Entry 3A of the said Notification was not available.
- It may be noted different interpretation has been adopted by different State AARs on classification of such contracts, which is causing significant commercial implication as well as uncertainty.

MFAR Hotels and Resorts Private Limited [Order No 28/ ARA/ 2020]

Classification and taxability of various supplies made by hotel

FACTS OF THE CASE

- Applicant is a 5-star hotel offering variety of services such as rooms, suites, banquets, dining, spa, etc to customers.
- Through this advance ruling application, Applicant seeks clarification on following questions:
  - Rate of GST applicable on standalone supply of soft or aerated beverages is for in-house or dine-in only guests?
  - Rate of GST applicable on supply of cigarettes?
  - Whether supply of alcoholic liquor for human consumption qualifies as exempt supply, thereby requiring reversal of input tax credit?
  - Whether supply of food to employees without consideration, which is obligatory and a contractual requirement, should qualify as free supply and attract reversal of input tax credit?

RULING

- Tamil Nadu AAR held that supply of soft or aerated beverages, whether in restaurant or as part of room services involves supply of goods as well as supply of service in form of usage of facilities or staff of the restaurant. Such supplies are naturally bundled and should qualify as composite supply as per Section 2(30) of the CGST Act. Applicable GST rate on such supplies should be 18% (9% each in case of CGST and SGST).
- Similarly, as regards supply of cigarettes, it was observed that supply involves goods as well as services by the restaurant. However, such supplies cannot be construed as naturally bundled as part of restaurant services. Instant supply should thus constitute a mixed supply and attract GST at a higher rate of 28% (14% each in case of CGST and SGST) applicable on supply of cigarettes, along with levy of GST Compensation Cess.
- Further, supply of alcoholic liquor for human consumption should qualify as non-taxable supply in terms of Section 9(1) of CGST Act and thus, qualify as exempt supply. Although silent, it effectively implies that reversal of input tax credit should thus be applicable on such supplies in terms of Section 17 of the CGST Act read with Rule 42 of CGST Rules.
- In respect of free food provided to employees, AAR held that such activity should qualify as supply in terms of Schedule 1 of the CGST Act and taxable value thereof should be determined as per Rule 28 of CGST Rules. Interestingly, AAR failed to discuss the press release issued by CBIC, which classifies various aspects relating to free supplies by employer to employee.

NOTIFICATIONS/CIRCULARS

No	Reference	Particulars
1	**Notification No 7/ 2020 - Central Excise dated October 21, 2020 & Notification No 38/ 2020 - Customs dated October 21, 2020**	Grants exemption from excise duty and duties of customs in respect of goods cleared against duty credit scrip issued under the Rebate of State Levies (commonly known as **RoSL**) for garments and made-ups, subject to fulfilment of prescribed conditions.
2	**Notification No 5/ 2020-Central Tax (Rate) dated October 16, 2020**	Exempts satellite launch services supplied by Indian Space Research Organisation (**ISRO**), Antrix Corporation Limited and New Space India Limited
3	**Notification No 80/ 2020 - Central Tax dated October 28, 2020**	Extends the due date of furnishing annual return in Form GSTR-9 and reconciliation statement in Form GSTR-9C for FY 2018-19 to December 31, 2020.

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