CORPORATE UPDATE

DIRECT TAX

INTERNATIONAL TAXATION

I. Indian subsidiary does not constitute permanent establishment of foreign company in India

(Nokia Networks OY vs. JCIT [TS-289-ITAT-2018 (Del)])

Recently, the Special Bench, Delhi (majority view) of the Hon'ble Tribunal held that Indian subsidiary of the assessee did not constitute a fixed place Permanent Establishment (PE) or agency PE under the Double Taxation Avoidance Agreement between India and Finland (the DTAA). While two members of the Special Bench held in favour of the assessee, the third member of the Bench dissented and held that the Indian subsidiary was virtual projection of the assessee and as such constitutes a fixed place PE under the DTAA.

On facts, the assessee, Nokia Networks OY (a company based in Finland) sold GSM equipments manufactured by it to Indian telecom operators from outside India on principal to principal basis under independent buyer-seller arrangements. Furthermore, installation activities and other connected activities (including technical support services) were carried by its subsidiary Nokia India Pvt. Ltd. (NIPL) under separate independent contracts with Indian telecom operators. The assessee seconded some employees to NIPL for installation contract of NIPL and their salaries were paid by the assessee. NIPL also had a marketing support agreement with the assessee for which it was compensated with cost plus mark up of 5 percent and the same was not subjected to TP assessment. The employees of the assessee on their visits to India (for network planning, negotiation or signing contracts before supply of goods) were provided administrative facilities by NIPL like telephone, fax and conveyance. The assessee also had a Liaison Office (LO) in India.

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In the first round of litigation, the Delhi High Court (HC) held that offshore supply of equipments was not taxable in India and that the LO did not constitute a PE of the assessee. As regards the constitution of NIPL as PE/ business connection of the assessee, the HC remitted the issue to the Tax Tribunal to be decided afresh, noting factual errors in the order of lower authorities [(2012) 25 taxmann.com 225 (Del)].

The Tax Tribunal examined the concept of Fixed Place PE in the light of the DTAA, OECD model tax commentary, judicial precedents and commentaries of eminent professionals. The Tax Tribunal also referred to the Supreme Court decisions in the case of Formula One and E-Funds wherein it was held that 'disposal test' is an essential condition for incidence of a fixed place PE.

In light of the above principle, the Tax Tribunal held that providing telephone or fax or conveyance services cannot be equated with fixed place. Furthermore, the activities of the assessee in India were purely pertaining to network planning, negotiation and signing of contracts before offshore supply of goods and the same fall within the ambit of preparatory or auxiliary activities and as such, the question of attribution of profits to India did not arise.

The Tax Tribunal held that the test laid down by the Supreme Court shall not be satisfied in this case as nothing has been brought on record by the Revenue that any physical space was made available which could be said to be at the disposal of assessee for assessee's own business of supply and sale of equipments.

The Tax Tribunal observed that as per the erstwhile provisions (as it stood at the relevant time) of Article 5 of the DTAA, there was no such clause of 'Service PE'.

On the aspect of Dependent Agent PE, the Tax Tribunal observed that NIPL had not negotiated or concluded any contract of supply of equipment on behalf of and binding on the assessee. The entire contract of supply of equipment had been executed by the assessee outside India and no activity relating thereto had been performed in India. NIPL was an independent entity, carrying out its activities on principal to principal basis with Indian customers and bore its own entrepreneurial risks. Thus, the basic condition provided under Article 5(5) of the DTAA was not satisfied.

As regards Installation PE, the Tax Tribunal held that NIPL undertook the installation and connected contracts on principal to principal basis with the Indian customers and none of the onshore activities of NIPL subsidiary can be said to be devoted wholly and almost wholly on behalf of the assessee. The consideration accruing or arising under these contracts had already been assessed in the hands of NIPL. No installation activity was carried out by the assessee in India and as such there was no question of examining the installation activity for purpose of PE.

The Tax Tribunal further held that existence of a subsidiary does not by itself constitute PE of its parent entity as the subsidiary company constitutes an independent legal entity in the source state.

The Tax Tribunal rejected Revenue's stand that NIPL is a virtual projection of the assessee as employees were practically performing all kinds of work, and therefore, it had to be treated as a PE of assessee. The Tax Tribunal clarified that the concept of 'virtual projection' alone was not relevant but had to be seen in relation to fixed place or any other concept of PE. In absence of fixed place PE, virtual projection itself could not be held to be a factor for creation of a PE.

Thus, the Tax Tribunal Special Bench (majority view) held that incidence of a P.E. does not arise in the instant case.

However, dissenting from majority view, the third member of the Tax Tribunal held that NIPL was PE of assessee in India for the reason that the way and manner in which it carried out its business activities in India, it was a virtual projection of, or an extension of, the assessee in India. The dissenting member held that all the crucial marketing and support functions had been rendered by the Indian PE and relying of Rolls Royce decision, he noted that 35% of overall profits could be attributed to these functions.

II. AAR rules on existence of PE with respect to transaction processing fees received by MasterCard from Indian customer banks

(MasterCard Asia Pacific Pte. Ltd. Singapore [TS-304-AAR-2018])

The Authority of Advance Ruling ('the AAR') has ruled that MasterCard Asia Pacific Pte Limited ('the applicant') has a fixed place PE, service PE and dependent agent PE in India in terms of Article 5 of the tax treaty between India and Singapore.

In the instant case, the applicant, a Company registered in Singapore, is MasterCard's regional headquarters for the Asia Pacific, Middle East, and Africa and a wholly owned indirect Singapore subsidiary of MasterCard USA. The applicant has a subsidiary in India, MasterCard India Services Private Limited (MasterCard India).

The applicant sought ruling from the AAR on taxability in India of transaction processing fees for provision of services of authorization, clearance and settlement of card-based transactions as well as additional fees for incidental services, which it receives from Indian banks and other financial institutions (the customers). The service involves electronically processing of payments between a cardholder's bank and a merchant's bank using the MasterCard Worldwide Network (the Network). Each customer is provided with MasterCard Interface Processor (MIP) which is located at customer's premises and connected the customer to the Network. MasterCard India owns and maintains the MIPs and also provides support services.

For ten financial years prior to FY 2014-15, MasterCard USA had admitted existence of PE in India under MAP settlement and had offered 100% of the income arising from its Indian operations to tax in India. In FY 2014-15, the group restructured and Indian activities and employees of MasterCard USA were transferred to a newly formed company by the name of MasterCard India.

The AAR, upon examination of the facts of the case, ruled as under:

- The MIPs creates a fixed place PE of the applicant in India as such MIPs are at the disposal of the applicant through licensing agreement and MasterCard Rules (even though these are owned by MasterCard India). Furthermore, the applicant is performing several key elements of the payment authorization process through these MIPs. Moreover, the functions as performed by MIPs do not fall within the ambit of preparatory or auxiliary activities.

- MasterCard Network (comprising of MIPs, MasterCard application software, transmission towers, leased lines, etc) also constitutes a fixed place PE of the applicant in India as a part of it is located in India.

  The same is at the disposal of the applicant as its sister company is involved in the management and maintenance of the Network and the application software used to access the MasterCard network is owned and controlled by the applicant.

  Also significant activities relating to clearance and settlement of funds between banks of cardholders and merchants by the settling bank takes place in India.

- Bank of India also constitutes a fixed place PE of the applicant in India, as certain space is occupied by a dedicated team of such bank which carries out the settlement activity under the direction and on behalf of the applicant and such space is at the disposal of the applicant.
- Since in earlier years MasterCard USA had offered to tax in India the entire income from Indian operations, after restructuring, the applicant cannot claim that MasterCard India is only carrying on support activities, which could not result in a PE.

  All facilities, services and personnel of MasterCard India are at the disposal of the applicant and thus, MasterCard India constitutes a fixed place PE of the applicant in India.

  The applicant's analysis of functions performed, assets employed, and risks assumed (FAR) by MasterCard India was rejected on the ground that the same did not accurately reflect the nature of activities performed by it, since the very same activities that were previously classified as transaction processing activities were now sought to be classified as support activities.

- The services performed by visiting employees of the applicant in India, such as seeking customer feedback, providing information about new products, and monitoring the efficiency of operations are an integral part of the transaction processing services, which leads to constitution of a Service PE of the applicant in India.

- MasterCard India habitually secures orders wholly for the applicant, thereby resulting in the constitution of a dependent agent PE of the applicant in India.

- Payments made by Indian customer banks to the applicant for grant of license to use MasterCard intellectual property rights (owned by MasterCard USA) constitute royalty.

  Such payments could also be classified as payments for the use of equipment (MIPs), or as payments for use of a secret process (being the workings of the MIPs), or as payments for use of software (being the application software used for accessing the Network) and would therefore amount to royalty.

  However, since such royalty payments are effectively connected with PE of applicant in India, they would be taxed as business profits under Article 7 of the tax treaty, and not as royalty.

- The remuneration paid by the applicant to MasterCard India is not at arm's length considering the FAR analysis of MasterCard India and as such, further attribution of profits to India is required.

In view of the aforesaid, the Tax Tribunal held that the subsidiary of the Finnish company would not constitute a P.E. in India.

III. Mere non-furnishing of Tax Residency Certificate does not disentitle treaty benefits

(Skaps Industries India Pvt. Ltd. vs. ITO, International Taxation [TS-330-ITAT-2018(Ahd)])

The Tax Tribunal, Ahmedabad Bench has held that treaty benefits are not to be denied to non-resident assessee merely on account of non-furnishing of tax residency certificate (TRC).

While holding so, the Tax Tribunal noted that Section 90(2) [which provides that treaty provisions shall be applicable in case they are more beneficial to the assessee] is a non-obstante provision, i.e. the same shall prevail despite anything to the contrary in the Act. For this reason, the provisions of Section 90(2) shall prevail over Section 90(4) which requires a non-resident to produce TRC to claim treaty benefits. The Tax Tribunal held that the assessee cannot be declined treaty protection under section 90(2) for the reason that the said assessee could not furnish TRC. Section 90(4) cannot be construed as limitation to or rider to unqualified treaty override stipulated in Section 90(2) and the said provision can only be pressed into service as a provision beneficial to the assessee.

However, the Tax Tribunal remarked that the assessee is required to satisfy his eligibility for treaty provisions nevertheless by furnishing sufficient and reasonable evidence of its residence.

IV. Final rules dealing with special transitional provisions for foreign companies regarded as Indian tax resident in terms of 'Place of Effective Management' (POEM)

(Notification No. 29/2018/F.No. 370142/19/2017-TPL)

In order to lay down special provisions (dealing with the computation of total income, treatment of unabsorbed depreciation, set off or carry forward of losses and avoidance of tax) for companies being regarded as Resident in India under the POEM framework, Section 115JH of the Income-tax Act was introduced vide Finance Act, 2016. The said provisions empower the Central Board of Direct Taxes ('the CBDT') to lay down exceptions, modifications and adaptations required for computing income chargeable to tax in respect of such foreign companies. In June 2017, the CBDT issued draft rules providing such exceptions, modifications and adaptations.

Recently, the CBDT has issued final rules effective from April 01, 2017. The final rules cover following additional aspects:

1. Determination of opening Written Down Value (WDV) of depreciable assets where foreign company is assessed to tax in the foreign jurisdiction and where depreciation is not considered for computation of taxable income in foreign jurisdiction;
2. Allowability of foreign tax credit;
3. Period for which and incomes against which brought forward loss or unabsorbed depreciation shall be allowed to be set off and carried forward; and
4. It has also been clarified that in case a provision specifically applicable to a foreign company is in conflict with a provision applicable to residents, the provision specifically applicable to the foreign company shall prevail.

(Contributed by: Anuj Mathur/ Ritu Theraja)

TRANSFER PRICING

I. Reimbursement of market survey expenses to AE benefitting the Indian taxpayer held to be different from shareholder's activity

(BMW India Pvt. Ltd. [TS-401-ITAT-2018(DEL)-TP])

In a recent decision, the Tax Tribunal, Delhi Bench, held that the market survey expenses recovered by Associated Enterprise ('AE') benefitted the taxpayer, being India specific and are different from shareholder's activity, as such allowable in the hands of taxpayer. Further, the Tax Tribunal accepted the comparable agreements extracted from Royalty Stat database relied upon by the taxpayer to benchmark payment for technical support services.

On the facts of the case, the taxpayer, engaged in selling BMW cars in India, entered into several international transactions with its AEs which were accepted by the Transfer Pricing Officer (TPO) to be at arm's length except for the transaction of reimbursement of market survey expenses and payment for technical support services.

a) Reimbursement of market survey expenses

The AE (BMW AG) recovered from the taxpayer actual cost paid to third party for the market survey report ('MSR') of Indian market without any mark-up. The taxpayer applied Comparable Uncontrolled Price (CUP) method to justify the arm's length price ('ALP') of the transaction wherein the third party payment by the AE was relied upon as CUP. However, the TPO made adjustment in respect of such transaction determining the ALP as Nil on the following grounds: (a) The MSR was prepared on the request of AE and was carried to benefit the AE, and (b) Indian market is of immense strategic importance for the group as a whole and as such, the AE would have anyway undertaken the survey. On an appeal, the CIT(A) upheld the adjustment made by TPO.

Before the Tax Tribunal, the taxpayer submitted that the MSR was prepared solely for its benefit as the report relates entirely to the Indian market and BMW cars are sold in India exclusively through the taxpayer. It was further submitted that shareholder services are undertaken by parent company to further its interest in the group as an owner and that arranging country specific MSR is for the benefit of entity in that country and any benefit to the parent company is only indirect/ incidental in nature. It was also submitted that the revenue authorities cannot question the commercial decision of a businessman and that the TPO did not provide details of any CUP based on which ALP was determined as Nil.

The Department representative supported the order of TPO and argued that the taxpayer was unable to justify involvement of its AE if such transaction did not benefit the AE.

The Tax Tribunal agreed with the submissions made by the taxpayer that activity of carrying out market survey is different from shareholder's activity as it is country specific and based on the review of documents placed on record, held that the TPO was not justified in determining ALP of the transaction as Nil.

b) Payment for Technical Support Cost

The taxpayer availed technical training from its German AE against which payments were made at the rate of Euro 700 per day. To benchmark said transaction taxpayer applied CUP method and relied upon the rates from two selected comparable agreements sourced from the Royalty Stat database involving provision for similar services in developed countries like US and Japan.

The TPO rejected comparable relied upon by the taxpayer stating that the service providers in both the agreements are not from Germany as in the case of taxpayer. The TPO carried out his own search for daily rate of automobile engineers in Germany on the world wide web (internet) and considered Euro 300 per day as CUP.

On an appeal, the CIT(A) upheld the adjustment made by the TPO considering the rate of Euro 300 per day, however, allowed the travel and lodging expenses included in such payments, being third party cost reimbursed at actuals.

Before the Tax Tribunal, the taxpayer contended that the TPO had extracted rates from random website which could not be verified and as such, cannot be used as CUP. About comparable agreement relied by it, the taxpayer submitted that the pricing/ cost structures and market dynamics of developed countries like Germany, USA and Japan are very similar and therefore, comparable agreement sourced from Royalty Stat should be accepted as CUP. The taxpayer also placed reliance on the case of Bharti Airtel Ltd. V. Addl. Commissioner of Income Tax, Delhi [TS-77-ITAT-2014 (DEL)-TP] where in it was held that under CUP method difference in geographical location of market is not sufficient reason to reject a comparable until it can be substantiated that the same resulted in different market conditions.

Considering the aforesaid, the Tax Tribunal decided in favour of comparable sourced from the Royalty Stat and rejected rates extracted by the TPO as the same are not contemporaneous and are not actual rates. Accordingly, adjustment made by the TPO was deleted.

(Contributed by: Shweta Kapoor)

DOMESTIC TAXATION

I. For claiming exemption under section 47(vib) from capital gain on transfer of capital asset by the demerged company to the resulting company in a demerger, the conditions prescribed under section 2(19AA) should be fulfilled

(ITO v. Ms/ Datex Ohmeda (India) Pvt. Limited (ITA no. 2038/KOL/2014)

The Tax Tribunal, Kolkata Bench, held that capital gain arising on demerger can be claimed exempt under section 47(vib) of the Act only if the conditions of 'demerger' prescribed under section 2(19AA) of the Act are fulfilled. However, where such conditions are not fulfilled and capital gains become liable for tax under section 50B of the Act, no computation of capital gains can be made if transfer / demerger is executed in exchange of shares of the resulting company and no monetary consideration flows to the demerged company.

In the present case, the tax payer, an Indian company, is a subsidiary of a Finland company and is engaged in the business of trading and servicing of medical equipment. It was decided to transfer the Trading and Distribution ('T&D') Division of the tax payer to another Indian company i.e. Wipro GE Healthcare Private Limited ('Wipro'). The demerger of T&D division was approved by the High Court of Calcutta and High Court of Karnataka with retrospective effect from April 1, 2008.

The capital gains arising from such demerger were claimed as exempt under section 47(vib) by the tax payer while filing its return of income. However, the tax officer rejected the claim of exemption on the premise that complete unsecured loans, taken from its parent entity, as appearing in the books of accounts of the tax payer before demerger, were not transferred to Wipro, and therefore conditions stipulated in section 2(19AA), which requires all the property and liabilities of the undertaking immediately before demerger should become the property and liabilities of the resulting company by virtue of the demerger, are not fulfilled. Therefore, capital gains are to be computed under section 50B (Special provisions for computing capital gains in case of Slump Sale) of the Act.

In the appeal before the CIT(A), the tax payer contended that such unsecured loans were converted to equity before filing the petition before the High Court and therefore could not be transferred to Wipro. The CIT(A) reversed the order of the tax officer.

On appeal by the revenue, the Tax Tribunal, Kolkata Bench held that the balance sheet of T&D division of tax payer reflects total unsecured loans of Rs. 601.29 Million as on 31.03.2008. Further, since conversion of loan in to equity share took place in August 2008, subsequent to the effective date of the demerger, the contention of the tax payer regarding conversion of loan prior to the demerger cannot be accepted.

Therefore, it was held by the Tax Tribunal that the demerger is not carried on in a manner envisaged in section 2(19AA) and accordingly, the same cannot be regarded as a demerger for the purpose of the Act. Thus, benefit available under section 47(vib) cannot be availed by the tax payer.

Alternatively, the tax payer also contended that consideration for transfer of its T&D Division, by way of demerger, was received in the form of shares of Wipro-GE by the shareholders of the tax payer. Therefore, in the absence of any monetary consideration involved in the transaction, the capital gain cannot be computed in the hands of the tax payer. The Tax Tribunal accepted the contention of the tax payer and held that in the present case, there is no transfer within the meaning of section 2(42C) [meaning of slump sale] and therefore, there can be no capital gain chargeable to tax under section 50B of the Act.

(Contributed by: Purnima Bajaj)

II. Non-disposal of objections of the assessee against reopening of assessment would not make reassessment order void ab initio

(Home Finders Housing Ltd. v. Income-tax officer, [2018] 94 taxmann.com 84 (SC))

In a recent decision, the Supreme Court dismissed the SLP filed by the assessee against the High Court order wherein the High Court had held that non- disposal of objections of the assessee by the assessing officer would not make reassessment order void ab initio.

In the instant case, the assessee, a real estate promoter, filed its nil return of income for the assessment year 2012-13. After completion of assessment, The Income-tax Officer issued notice under section 148 furnishing reasons for invoking section 147 of the Act. The assessee on receipt of reasons, submitted its objections. The Income-tax Officer without disposing off the objections, continued with the proceedings and passed a fresh assessment order.

The assessee filed a writ petition before the High Court, on the ground that the Income-tax Officer violated the law declared by the Supreme Court in GKN Driveshafts (India) Ltd. v. ITO [2002] 125 Taxman 963/ [2003] 259 ITR 19 by not disposing off the objections of the assessee against the reopening of the assessment. The learned single Judge set aside the order and directed the the Income-tax Officer to consider the matter afresh after giving disposal to the objections.

On appeal before the two Judge bench of the High Court, the assessee contended that the violation of a mandatory procedure cannot be cured by remitting the matter and failure to follow the essential procedure would result in declaring the assessment order void and non-est. Further, the assessee also submitted that non-compliance of a prescribed procedure would nullify the order and the irregularity cannot be cured later.

The revenue contended that the failure to follow the procedure is only an irregularity, which would not vitiate the ultimate order. The High Court held that the Hon'ble Supreme Court in GKN Driveshafts (India) Ltd's case gives a procedural safeguard to the assessee to avoid unnecessary harassment by directing the the Income-tax Officer to pass a speaking order taking into account the objections for reopening the assessment under section 147 of the Act. The non-compliance of the procedure indicated in the GKN Driveshafts (India) Ltd.'s case would not make the order void or non-est. Such a violation in the matter of procedure is only an irregularity which could be cured by remitting the matter to the authority.

The High Court also distinguished the reliance placed by the assessee on the decision of Supreme Court in Sona Builders v. Union of India [2001] 10 SCC 280, by observing that in the said case of Sona Builders notice to the assessee was posted only five days prior to the limitation period for passing the orders and on such facts and circumstances, the Supreme Court quashed the proceedings without remitting it for passing fresh order.

The High Court therefore held that in case an order is passed without following a prescribed procedure, the entire proceedings would not be vitiated. It would still be possible for the authority to proceed further complying with the particular procedure.

(Contributed by: Ankita Mehra)

III. The Tax Tribunal allowed exemption under section 10AA of the Act by importing definition of 'service' from SEZ Act and Rules

(M/s. Midas DFS (P) Ltd. v. Income-tax Officer [TS-292-ITAT-2018 (Kol)])

In a recent judgement of the Tax Tribunal, Kolkata Bench, the assessee was allowed the benefit of section 10AA of the Income Tax Act, 1961 ('Act') in respect of international trading, warehousing and consultancy income by importing the definition of 'service' from SEZ Rules.

The assessee company was engaged in trading activity, warehousing and consultancy services from Special Economic Zone ('SEZ') within the duty-free sector. The assessee company had claimed tax exemption of the abovesaid income under section 10AA of the Act (which is granted to newly established units in SEZs for "manufacture or production of articles or things" or for "providing any services").

The Income Tax Officer denied the exemption under section 10AA of the Act for all the aforesaid incomes for the reason that assessee was not engaged in manufacturing or production of article or thing.

Before the Ld. CIT(A), the assessee contended that as per the SEZ Act 2005 and Rules, definition of service includes trading and warehousing activity. However, Ld. CIT(A) disregarded the claim of assessee by stating that definition of 'service' as provided under the SEZ Rules cannot be applied in the income tax proceedings as the provisions of SEZ Act cannot override the specific provisions of Income Tax Act ,1961.

The Tax Tribunal noted that SEZ Act provides for specific overriding provision over other laws (including Income Tax Act) and also since it is a Special and a later Act of the Parliament, the definition of service can be imported from SEZ Act into the Income tax Act.

(Contributed by: Manali Gupta)

IV. Consent/Settlement charges paid to SEBI is an allowable business expense

(DCIT–Vs. Anil Dhirajlal Ambani – [2018] (93 taxmann.com 492 (Mumbai – Trib.))

In a recent decision, the Mumbai Bench of Tax Tribunal has held that consent/settlement charges paid to Securities Exchange Board of India ('SEBI') would be admissible under Section 37 (1) of the Income-tax Act, 1961 ('the Act').

The SEBI had conducted preliminary investigation against Mr. Anil Dhirajlal Ambani ('the Assessee'), in respect of certain alleged offences for violation of SEBI regulations. To avoid protracted litigations, damage to reputation and loss of time etc., the assessee availed the SEBI's guidelines relating to 'consent terms' for settlement of the matter. In pursuance thereof, the assessee filed a consent application with the SEBI. The SEBI, on consideration of such application levied charges amounting to Rs. 50 crores which was claimed as settlement expenditure in relation of income earned by way of commission and sitting fee.

The Income-tax Officer disallowed such expenditure under Section 37(1) of the Act on the premise that the said payments were in the nature of penalty. The CIT(A) deleted the impugned addition on the ground that the consent settlement paid by the assessee lies between prima facie indication of an offence and final culmination in levy of penalty or any other punishment. The CIT(A) also placed reliance on the decision of the Tax Tribunal in the case of ITO v. Reliance Shares & Stock Brokers (P.) Ltd. [2014] 51 taxmann.com 25 (Mum.), wherein, a similar issue was dealt with and relief was provided to the assessee.

Before the Tax Tribunal, Mumbai Bench, the revenue contended that the payment was nothing but a penalty for grave statutory violations of various provisions of SEBI Act and the said payment was made for escaping the legal consequences of the defaults committed and to prevent further legal action.

The Tax Tribunal, while deciding the case in favour of the assessee, held that the consent charges were voluntarily paid by the assessee, without admission of the guilt. The Tax Tribunal also noted that the consent application was filed on the apprehensions of long drawn litigation and other factors such as time, cost and reputation, while no actual finding of offence was made by any authority.

Moreover, the Tax Tribunal observed that the violations made in the instant case were similar as in the case of Reliance Shares (Supra). The Tax Tribunal noted that SEBI had, in both the cases, initiated action under Section 11 of the SEBI Act read with Regulations 11 of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003. The payments in both the cases have also been made without admitting or denying the guilt. Based on the said decision, the payment so made cannot be characterized as a payment made for an 'offence' and not 'prohibited by any law'. The payment also does not fall within the ambit of explanation to Section 37(1) as provided in the CBDT Circular No. 772 dated 23-12-1998. The explanation to the section applies to the prohibited payments such as bribes etc. and hence do not apply to payments arising as a consequence of an offence as in the present case.

The Tax Tribunal therefore, upheld the order of CIT(A) and held that since the payment was made without admitting or denying the guilt and was paid only to settle the dispute, the said settlement charges/consent fee could not be equated with penalty for violation of law under Section 37(1) and thus, an allowable business expenditure.

(Contributed by: Ritu Gyamlani)

V. Share valuation can be challenged by the tax authorities in the absence of verification of the figures furnished by the assessee to Merchant Banker.

(Agro Portfolio (P.) Ltd. Vs. ITO [(2018) 94taxmann.com 112 (Delhi Tribunal)])

The assessee was engaged in the business to acquire, purchase or otherwise held shares, stocks, etc. The Assessee allotted 3,15,000 equity shares of face value of Rs.10 each at a premium of Rs.40 per share. The share market value was determined at Rs.50 by the MerchantBanker in the valuation report issued on the basis of DCF method.

The Income Tax Officer made addition of Rs.1.27 crores taxing the share premium under section 56(2)(viib) (which provides for taxation of consideration for issue of shares as exceeds the fair market value of shares) and rejected the valuation report of the Merchant Banker on the basis that the evidences for substantiating the basis of projections in cash flow and its reasonable connectivity with the documents furnished were not provided by the assessee and the basis of calculation of cost of capital and discounting factor was not explained. The Income-tax Officer thus independently determined the value of the share at Rs.9.60 each. The amount over and above the value of share over Rs.9.60 i.e. Rs.40.40 each was added to the assessee's income.

The appeal of the assessee was dismissed by the Commissioner (Appeals).

On further appeal to the Tax Tribunal, the assessee contended that in view of the provisions under section 56(2)(viib), read with rule 11UA, the Income Tax Officer has no jurisdiction to adopt a different method than the one adopted by the assessee, and if for any reason the Income Tax Officer has any doubt regarding such valuation report and does not agree with the same he is bound to make a reference to the Income Tax Department Valuation Officer.

The Tax Tribunal rejecting the contentions of the assessee held that until and unless the assessee produces the evidences to substantiate the basis of projections in cash flow and provides reasonable connectivity between those projections in cash flow with the reality evidences by the material, it is not possible even for departmental Valuation Officer to conduct any exercise of verification.

For all these reasons, the Tax Tribunal was of the considered opinion that the Income-tax Officer is left with no other option but to reject the DCF method and adopt NAV method to determine the FMV of the shares. While confirming no illegality or irregularity in the approach and conclusions by the authorities below the Tax Tribunal dismissed the appeal as devoid of merits.

VI. Interest Income from share application money can be adjusted against public issue expenses.

(CIT Vs. Shree Rama Multi Tech Ltd. [(2018) 92 Taxmann.com 363 (SC)])

The Supreme Court of India has held that interest income earned out of the share application money is not liable to be taxed as 'Income from Other Sources' and could be set off against the public issue expenses the assessee has incurred, as the interest earned was inextricably linked with the requirement of the company to raise share capital and is thus adjustable towards the expenditure involved in the share issue.

On the facts of the case, Shree Rama Multi tech Ltd. ('Assessee') was statutorily required to keep share application money in a separate account till the allotment of shares was completed. Interest earned on such money was claimed to be set off against the public issue expenses. The claim was allowed by the Tax Tribunal and upheld by the High Court of Gujarat.

Before the Supreme Court, the revenue argued that the claim of the assessee could not be accepted as part of the share application money would have to be returned to unsuccessful applicants and therefore, the entire share application money would not be appropriated by the company.

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The Supreme Court affirming the High Court's order held that the interest earned was inextricably linked with requirement of company to raise share capital and was thus adjustable towards the expenditure involved for the share issue. The Supreme Court thus decided the issue in favour of the assessee.

(Contributed by: Shilpa Sharma)

CORPORATE LAW

1. Amendment in Section 89 and Section 90 of Companies Act, 2013 and notification of Companies (Significant Beneficial Owners) Rules, 2018

Section 89 - The existing Section 89 of the Companies Act, 2013 ["the Act"], which deals with declaration in respect of beneficial interest in shares, provides for submission of declaration by the following persons to the respective company:-

- the person whose name is registered with the company as the holder of shares, but who does not hold beneficial interest in those shares; and

- the person who actually holds or acquires beneficial interest in the shares but is not registered as a holder of those shares with the company.

It may be noted that as the term 'person' is used in Section 89, therefore it provides for declaration of beneficial interest by all types of members i.e. both natural person and artificial person including body corporate.

Further, as no benchmark is laid down in Section 89 w.r.t. holding of shares, therefore irrespective of the number or percentage of shares involved, both the registered as well as the beneficial owner of shares are required to submit declaration in prescribed forms to the concerned company.

The Companies (Amendment) Act 2017 has amended Section 89 of the Act which inter-alia defines 'beneficial interest in a share', as contained below, to be seen from the perspective of Section 89 as well as Section 90 of the Act. The amended Section 89 has come into force with effect from 13th June 2018 vide Ministry of Corporate Affairs [MCA] notification No. S.O. 2422(E) dated 13th June, 2018.

Beneficial interest in a share includes direct or indirect, through any contract, arrangement or otherwise, the right or entitlement of a person alone or together with any other person, to-

(i) exercise or cause to be exercised any or all the rights attached to such share; or
(ii) receive or participate in any dividend or other distribution in respect of such share

Section 90 & its rules - The Companies (Amendment) Act 2017 has also amended Section 90 of the Act, by way of substitution of existing Section with a new Section 90 and the amended Section 90 has come into force with effect from 13th June 2018 vide MCA notification No. S.O. 2422(E) dated 13th June, 2018.

It is pertinent to note here that the MCA vide Notification No. G.S.R. 561(E) dated 13th June, 2018 has notified Companies (Significant Beneficial Owners) Rules, 2018 hereinafter referred to as "the rules" under Section 90 of the Act. The rules have been notified for the first time and have come into force w.e.f. 14th June, 2018.

As per the rules, significant beneficial owner means an individual referred to in sub-section (1) of section 90 (holding ultimate beneficial interest of not less than ten per cent), read with sub-section (10) of section 89, but whose name is not entered in the register of members of a company as the holder of such shares, and the term 'significant beneficial ownership' shall be construed accordingly.

It may be noted that unlike Section 89, in Section 90 the term 'individual' has been used and further, as the rules only envisages a 'company' [which does not include a body corporate] to be a member of other company, therefore in those cases where a body corporate holds significant beneficial ownership in shares of a company, the provisions of Section 90 will not apply.

Declaration of significant beneficial ownership in shares - Every individual who holds significant beneficial ownership in shares of a company, as on the date of commencement of the rules needs to file a declaration in Form BEN-1 to the concerned company within 90 days from such commencement i.e. on or before 13 September 2018. In the event of acquisition of significant beneficial ownership by an individual after commencement of these rules, Form BEN-1 needs to be filed to the company within 30 days of such acquisition.

In both the above cases, the significant beneficial owner is also required to file Form BEN-1 within 30 days of any change in his significant beneficial ownership.

Filing of return by the company - Upon receipt of above mentioned declaration in Form BEN-1, the company needs to file a return in Form BEN-2 with the Registrar of Companies within 30 days from the date of receipt of such declaration.

Further, a register of significant beneficial owners is also required to be maintained by the company in Form BEN-3.

Non –applicability - The above mentioned provisions are not applicable to holding of shares of companies/body corporate in case of pooled investment vehicles such as Mutual Funds, Alternative Investment funds(AIFs), Real Estate Investment Trusts(REITs) and Infrastructure Investment trust (InvITs) regulated under SEBI Act.

(Contributed by: Shikha Nagpal)

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June, 2018

IMPORTANT

DATES TO REMEMBER

Particulars	Date
Deposit of TDS for the month of July, 2018	August 7, 2018
Date of deposit of GST and filing of GSTR-3B for the month of July, 2018	August 20, 2018
Filing of GSTR 1 in the month of July 2018	August 10, 2018

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