CORPORATE UPDATE

IN THIS ISSUE

DIRECT TAX

INTERNATIONAL TAXATION

I. High Court upholds grossing up for withholding tax purpose where taxes are borne by customer on fees for technical services paid to non-resident even where tax treaty prescribes applicable rate.

II. The Supreme Court dismisses SLP filed by Revenue on the issue of supervisory P.E. and FTS.

III. CBDT notifies protocol amending India-Portuguese DTAA.

IV. Withholding of tax on 'Employee Stock Option Plans' (ESOPs) to be made on the date of allotment of shares and not on date of exercise of option.

V. Foreign assignment allowance received in abroad by an employee being Non-Resident during the year for services rendered outside India is not taxable in India as per Sec 5(2).

TRANSFER PRICING

I. SC dismissed SLP of tax department dealing with the issue of exclusion / inclusion of comparable companies.

DOMESTIC TAXATION

I. Expenditure incurred on an Abandoned Business Project is allowable if tests of common control, unity of command satisfied.

II. Amount saved on premature payment of Sales Tax Liability is not taxable.

III. Non-reporting of the receipt of income from royalties/ Fees for Technical Services (FTS) even if tax has been deducted at source (TDS) is a valid ground for reopening of assessment.

DIRECT TAX

INTERNATIONAL TAXATION

I. High Court upholds grossing up for withholding tax purpose where taxes are borne by customer on fees for technical services paid to non-resident even where tax treaty prescribes applicable rate.

(*TVS Motor Co. Ltd. Vs. ITO, International Taxation, Chennai* [2018] 96 taxmann.com 567 (Madras)

Recently, the High Court of Madras held that where the assessee had made payment to a non-resident towards fees for technical services ('FTS') on a 'net of taxes' basis, the assessee was liable to deposit tax at source ('TDS') on grossed-up amount.

On facts, the assessee had entered into agreement with a UK based University for providing technical services and as per the agreement in terms of which the Income-tax was to be borne by the assessee. The assessee deposited TDS at the rate of 15% in terms of Article 13 of the Double Taxation Avoidance Agreement between India and UK ('the DTAA') on the amount actually paid.

The Income-tax Officer held that under Section 195A of the Income Tax Act, if tax chargeable on any income is borne by the payer of income, then for the purpose of TDS, the contractual amount should be increased to such amount as would after deducting TDS, be equal to the net amount payable. The Income Tax Officer pointed out that the assessee failed to gross-up the amount as paid for TDS purposes as required by section 195A and as such, there was short deposit of TDS by the assessee. Resultantly, the Income-tax Officer passed an order under section 201 and raised a demand towards shortfall of TDS and interest thereon. The Commissioner of Income Tax (Appeals) and the Tax Tribunal also upheld the order of the Income-tax Officer.

Before the High Court, the assessee, referring to Article 13 of the DTAA, contended that only actual amount paid to the non-resident must be regarded as FTS income and tax borne by the assessee does not constitute FTS income in the hands of the non-resident. It was also argued that in terms of Section 90 of the Income-tax Act, the provisions of DTAA would apply if the same are more beneficial as compared to the Income-tax Act and accordingly, the provisions of Article 13 shall override Section 195A of the Income-tax Act.

Furthermore, the assessee contended that the expression "gross amount" appearing in Article 13 of the DTAA only refers to the gross amount paid without deduction of expenses and that the said clause cannot refer to a different sum other than mentioned in Article 13.

However, the High Court held that the DTAA does not define the terms 'gross amount' and 'income' and thus, one has to be guided by the definition of 'income' as defined under Section 2(24) of the Act, which includes, tax borne by the assessee. The High Court also held that the provisions of the DTAA do not provide a mechanism for computation of income and prescribes only the rate of tax.

In view of the aforesaid, the High Court held that the amount payable to the non-resident ought to have been grossed up in terms of Section 195A, for the purpose of computation of TDS.

(Contributed by: Ritu Theraja)

II. The Supreme Court dismisses Special Leave Petition filed by Revenue against the judgement of the High Court of Delhi on the issue of supervisory permanent establishment and FTS.

(CIT vs. Sumitomo Corpn.[2018] 96 taxmann.com 612 (SC)

The Supreme Court has dismissed Special Leave Petition filed by the Revenue against order of the High Court of Delhi dealing with the issue of supervisory permanent establishment ('PE') and FTS.

The High Court had held that where period of supervision under contract between the assessee, a Japanese company, and Indian customer did not exceed 180 days, it would not constitute a supervisory PE in terms of Article 5(4) of the DTAA between India and Japan. Further, such consideration must be regarded as FTS liable to be taxed at 20 per cent under Article 12(2) of the DTAA. While holding do, the High Court stated that for the purpose of the duration test of 180 days prescribed in the supervisory PE clause, the duration of unrelated contracts must not to be aggregated.

(Contributed by: Ritu Theraja)

III. CBDT notifies protocol amending India-Portuguese DTAA.

(Notification No. 43/F.No. 503/05/1991- 503/05/1991-FTD-I dated September 11, 2018)

The Central Board of Direct Taxes ('the CBDT') has notified that the protocol amending Article 26 - 'Exchange of Information' of the Double Taxation Avoidance Agreement between India and Portugal, as signed on 24th June, 2017 shall become effective from August 08, 2018.

(Contributed by: Ritu Theraja)

IV. Withholding of tax on 'Employee Stock Option Plans' (ESOPs) to be made on the date of allotment of shares and not on date of exercise of option.

(Bharat Financial Inclusion Ltd. vs. DCIT
[2018] 96 taxmann.com 540 (Hyderabad – Trib.)

The Hon'ble Tax Tribunal, Hyderabad bench, held that obligation of withholding tax on ESOP arises only when shares are allotted, after completion of commitments on part of the person who exercised the option and not on the date of exercise of option.

On the facts of the case, for the AY 2012-13, the assessee had granted compensation in the form of Employee Stock Options to one of his ex-employee. The assessee deducted tax on the date of allotment of shares. The Income-tax Officer held the assessee as assessee-in-default for late deduction/deposit of withholding tax and levied interest under Sec. 201(1A) of the Act with the view that withholding tax on ESOP should have been deducted on an earlier date of exercise of option and not on the later date of allotment of shares.

The assessee submitted that according to Explanation to Sec. 17(2)(vi) of the Act, definition of security includes shares allotted on ESOP and therefore is taxable under the head 'Salaries'. Further, according to Sec. 192(1) of the Act, any person responsible for deducting tax on any salary payable shall deduct such tax at the time of payment of salary. Therefore, combined reading of above sections concludes that tax was deductible on the date of allotment of shares to the employee.

The CIT(A) upheld the order of Assessing Officer sustaining interest levied u/s 201(1A) of the Act with respect to taxation of perquisite on ESOP.

The Tax Tribunal noted that once an employee exercises the option, the price of shares is freezed. That means, exercise of option is only acceptance of the proposal, which comes with some conditions/obligations on the part of person exercising the option viz. receipt of cost of shares along with withholding tax. Therefore, the transaction will come to an end when the person exercising the option completes his part of conditions/obligations. Further, Sec. 192 of the Act is applicable only when assessee makes the payment therefore perquisite is taxable only when assessee makes payment, in this case, allotment of shares.

Therefore, appeal of the assessee was allowed.

(Contributed by: Shashank Goel)

V. Foreign assignment allowance received in abroad by an employee being Non-Resident during the year for services rendered outside India is not taxable in India as per Sec 5(2).

(DCIT vs. Sudipta Maity [2018] 96 taxmann.com 336 (Kolkata – Trib.)

The Hon'ble Tax Tribunal, Kolkata bench, held that if any foreign assignment allowance is received abroad by any employee of an Indian company whose residential status was Non-Resident during the FY, the same would not be taxable in India as both accrual and receipt of income is outside India.

On the facts of the case, the assessee was sent to Switzerland for a short term assignment by his employer, IBM India Private Limited. The assessee had stayed outside India for 331 days during the year, therefore his residential status for the year under consideration was Non-Resident. The assessee received foreign assignment allowance from his employer when he was outside India during the year in the form of a Travel Currency Card (TCC) issued by Axis Bank. IBM India had deducted tax on the gross salary which included the foreign assignment allowance received by the assessee. The assessee in his Income Tax Return claimed for refund on tax deducted on foreign assignment allowance with a view that foreign assignment allowance had accrued and been received outside India, therefore the same is not taxable under Sec. 5(2) of the Act.

The Income-tax Officer without considering the contention of assessee made additions on account of foreign assignment allowance received by the assessee, with a view that the employment contract entered in India and the first point of receipt of the same occurs in India, as the salary is first deposited in India and thereafter it gets loaded in the TCC.

The CIT(A) deleted the addition and granted relief to the assessee.

The Hon'ble Tax Tribunal, noted from the facts placed on record by the assessee, that IBM instructs Axis Bank to issue TCC to its employees sent on foreign assignment and IBM transfer funds from its EEFC (Exchange Earners Foreign Currency) account (as maintained with Deutsche Bank in foreign currency) to Axis Bank's Nostro Account for the purpose of loading/reloading the Axis TCC issued to employees sent on foreign assignment. Also, the assessee sent on foreign assignment carries a TCC with zero balance and the same was loaded/reloaded only when the assessee was staying and rendering services outside India.

Further, the assessee duly paid taxes to Swiss Government on the subjected foreign assignment allowance.

Reliance was placed by the assessee on the ruling of Asstt. DIT vs. Sri Kartik Vyas [IT Appeal No. 375 (JP) of 2012, dated 31-12-2014], which was directly on the similar issue as in the case of another IBM employee, wherein it was held that foreign allowances received outside India for services rendered outside India was not liable to be taxed in India.

Therefore, it was held that the first point of receipt of allowance by the assessee was outside India. Since both accrual and receipt of income happens outside India, foreign assignment allowance was held to be non-taxable in India under the Act.

(Contributed by: Shashank Goel)

TRANSFER PRICING

I. SC dismissed SLP of tax department dealing with the issue of exclusion / inclusion of comparable companies.

(Sojitz India Pvt. Ltd. [ITA No. 742/2017])

In the case of Sojitz India Pvt. Ltd., Hon'ble Tax Tribunal Delhi Bench, while dealing with the issue of exclusion and inclusion of comparables under transaction net margin method, based on the functional analysis of the companies selected as comparable, directed the tax department to exclude / include the companies. Against such order of the Tax Tribunal, the tax department filed an appeal before Hon'ble High Court of Delhi. The High Court dismissed the appeal by the tax department by observing that the issue in appeal did not give raise to question of law and that the department has not taken any specific ground that the order of the Tax Tribunal was perverse. Against such High Court order, tax department filed a SLP before Supreme Court which was also dismissed.

Further, in the case of EXL Service.com India Pvt. Ltd. [ITA No. 574/2017] also, wherein the matter of dispute was exclusion / inclusion of comparable companies, the SLP was dismissed by Supreme Court.

(Contributed by: Shweta Kapoor)

DOMESTIC TAXATION

I. Expenditure incurred on an Abandoned Business Project is allowable if tests of common control, unity of command satisfied.

[M/s. Chemplast Sanmar Limited Vs ACIT][TS-506-HC-2018(MAD)]

In a recent decision, it has been held that expenses incurred on a new project which is subsequently abandoned shall be allowed as a deduction from the business income of the assessee provided that common funds were used in both lines of business along with common management and unity of command.

In the instant case, the assessee was engaged in the business of shipping and manufacture of PVC and caustic soda and had incurred certain expenditure on its new textile project during the relevant year. However, the new project did not materialize and hence the same was abandoned. The Assessee in its return of income claimed the said expenditure as revenue in nature. The Income-tax Officer disallowed such expenditure on the ground that such expenditure was capital in nature.

The CIT(A) and Hon'ble Tax Tribunal also upheld the order of Income Tax Officer by relying on the Madras High Court decision in case of EID Parry (India) Ltd. Vs. CIT [(2002) 257 ITR 0253] in which expenditure incurred on a new project was held to be capital in nature.

Before the High Court of Madras, the assessee contended that decisive factors for allowance are unity of control, management and common fund, etc. Assessee also relied

on the Delhi High Court decision in case of Jay Engineering Works Ltd. Vs. CIT [(2009) 311 ITR 0405] wherein it was held that the nature of new line of business is irrelevant and that for allowance of such expenditure, unity of control and management are decisive factors.

The High Court after looking into the facts of the case distinguished the decision of EID Parry (India) Ltd. (supra) which was relied upon by the revenue authorities and observed that the expenditure incurred by the Assessee in the said decision was in capital field and not on revenue side. The Madras High Court observed that in the present case, as held by CIT(A) also, the expenses incurred were all revenue in nature.

The Madras High Court, while placing reliance on the decision of Jay Engineering Works Ltd. (supra), held that unity of control, management and common funds are the decisive factors in such a case and hence the expenditure incurred by the Assessee stands allowed as revenue expenditure.

(Contributed by: Ritu Gyamlani)

II. Amount saved on premature payment of Sales Tax Liability is not taxable.

[CIT Vs. Balkrishna Industries Ltd.][{2017} 88 taxmann.com 273 (SC)]

The Hon'ble Supreme Court of India has held that the money saved by the Assessee by making premature payments towards deferral sales tax at Net Present Value (NPV) in accordance with the Maharashtra Government's Deferral Scheme of 1988, does not amount to remission or cessation of liability. As such the Supreme Court concluded that the same is not taxable under section 41(1) of the Act in the hands of the Assessee.

The Assessee had credited an amount of INR 4,14,87,985/- to Capital Reserve A/c on the contention that the said amount was a remission of loan liability. During the course of assessment proceedings, the Assessee explained that under a Scheme by Maharashtra State Government, the Assessee was entitled to defer the sales tax liability for a period of 7 years. However, in response to the offer of Maharashtra Government, the Assessee made a payment of INR 3,37,13,393/- at NPV against the total liability of INR 7,52,01,378/- and credited the differential amount to Capital Reserve A/c. The Income tax Officer taxed the different amount under section 41(1) by treating the same as remission of a trading liability.

The Special Bench of The Tax Tribunal, Mumbai decided the case in favor of the Assessee which was upheld by Bombay High Court.

The Hon'ble Supreme Court noted that the aforesaid issue was discussed in detail by the High Court. The High Court observed that the sales tax collected by the Assessee was treated as a loan by the State Govt. and hence the basic ingredient of Section 41(1)(a) that it was in the nature of a trading liability remained unfulfilled. Secondly, no benefit had accrued to the Assessee as the amount of present worth of the future payments was paid in advance. As such liability was fully discharged and the assessee was not benefitted, contrary to what was claimed by revenue.

The Hon'ble SC held the judgment by High Court is without any flaw and hence the revenues appeal was dismissed.

(Contributed by: Ritu Gyamlani)

III. Non-reporting of the receipt of income from royalties/ Fees for Technical Services (FTS) even if tax has been deducted at source (TDS) is a valid ground for reopening of assessment.

In the recent case of Samsung Electronics Co. Ltd. Vs Deputy Commissioner of Income Tax (Int. Tax), the Delhi High Court has held that reopening of an assessment is valid if the assessee fails to disclose taxable income even if the TDS had been deducted on income from royalty/FTS [TS 549-HC-2018(DEL)]

During the course of survey, it was found that the office of M/s Samsung India Electronics Ltd, a subsidiary of M/s Samsung Electronics Co. Ltd., South Korea, is being used as place of management for South Asia operations by the parent company.

On perusal of records, it was found that the assessee had not filed its return of income in India for AY 2007-08. As such, the AO had the reason to believe that income chargeable to tax has escaped assessment.

The assessee contended that the return has been duly filed by branch office under the name "Samsung Electronics Co. Ltd. – India Software Operations". However, the income earned by the assessee from the Indian subsidiary by way of FTS and royalty was not included in the return. The return was in a different name and was in respect of taxable income earned by the branch office, as a separate assessee.

In response to the notice issued under section 147/148 of the Act, the assessee filed return of income including FTS and income from Royalty from the Indian subsidiary.

The ITAT upheld the reassessment under section 147, rejecting the contention of the assessee that there was no escapement of income from assessment as tax was deducted at source on such income.

The High Court observed that since new and additional source of income were disclosed in the return of income filed under section 147/148 of the Act, the assessee accepted that the original return filed by the branch office was not in terms of the provisions of the Act and therefore, department did not have any opportunity to consider and examine the taxable income of the assessee. The deduction of tax at source and failure to disclose taxable income are different and distinct aspects.

As such, the appeal of the assessee against reopening of assessment was dismissed by the High Court.

(Contributed by: Ankita Mehra)

IMPORTANT

DATES TO REMEMBER

Particulars	Date
Deposit of TDS for the month of October, 2018	November 7, 2018
Date of deposit of GST and filing of GSTR-3B for the month of October, 2018	November 20, 2018
Filing of GSTR I for the month of October 2018	November 10th 2018

For further information, please contact:

Mr. C. S. Mathur

Tel: 91-11-47102200 Email: csm@mpco.in

Mr. Vikas Vig

Tel: 91-11-47103300 Email: vvig@mpco.in

Ms. Surbhi Vig Anand

Tel: 91-11-47102250 Email: surbhivig@mpco.in

Main Office

New Delhi
1 A-D, Vandhna
11, Tolstoy Marg
New Delhi-110 001

Tel: 91-11-47102200

www.mpco.in

MPC & CO LLP

Delhi
Pune
Vadodara

Associates

Ahmedabad
Bangalore
Chennai
Hyderabad
Mumbai

DISCLAIMER

The contents of this document are for information purposes and general guidance only and do not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice.

No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication and Mohinder Puri & Co. disclaims all responsibility for any loss or damage caused by errors/ omissions whether arising from negligence, accident or any other cause to any person acting or refraining from action as a result of any material in this publication.

© 2018 Mohinder Puri & Co.