CORPORATE UPDATE

10/2018

DIRECT TAX

INTERNATIONAL TAXATION

I. Tax Tribunal upholds application of provision of the domestic taxation law for one source of income and tax treaty for the other source.

(Dimension Data Asia Pacific Pte. Ltd. Vs. DCIT, Mumbai [TS-604-ITAT-2018 (Mum)

Recently, the Tax Tribunal held that the assessee is entitled to be governed by the domestic tax law for one source of income, while seeking relief under the tax treaty for the other source.

During the relevant assessment year, the assessee, a Singapore company, rendered management support services to its subsidiary in India namely Dimension Data of India Ltd (DDIL), mostly from Singapore. The assessee only spent 2 days in India for this purpose. Apart from this activity, the assessee also sent its employees from Singapore to India to provide DDIL with assistance/ guidance in respect of contract awarded by BSNL to DDIL for setting up of internet data centers in India. The employees stayed in India for 171 days on this account and the assessee charged a separate fee for the said technical services ('the service fee').

The assessee contended that though the "management fee" was fee for technical services (FTS) under section 9(1)(vii) of the Income tax Act, 1961 (the Act), the same was taxable as business profits under the Double Taxation Avoidance Agreement between India and Singapore ('the DTAA'). However, since the required threshold for

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constitution of Service PE under Article 5(6)(b) of the DTAA was not met, such business profits were not chargeable to tax in India. Thus, the assessee opted to be governed by the provisions of the DTAA, being more beneficial.

As regards "service fee", the assessee offered the same to tax as fee for technical services under section 9(1)(vii) of the Act and stated that the same should be taxed at the rate of 10% under section 115A(1)(b) of the Act on gross basis. The assessee contended that though Service PE was constituted in India as per the DTAA, yet the same was to be governed by the beneficial provisions of the Act.

The Assessing Officer ('the AO') aggregated the employees' stay on account of rendering of both the services and held that a service PE was constituted. The AO attributed entire receipts to India and allowed only 10% adhoc deduction towards expenditure. The balance amount was taxed as business profits at the rate of 40%.

On appeal, the Tax Tribunal observed that as per Section 90(2) of the Act, the assessee is entitled to claim benefits of the DTAA to the extent the same are more "beneficial" as compared to the provisions of the Act. The Tribunal, relying on certain judicial precedents, held that in cases of multiple sources of income, an assessee is entitled to adopt the provisions of the Act for one source while applying the provisions of the DTAA for the other.

Thus, the Tax Tribunal held that the management fee was not taxable in India under the provisions of the DTAA and the service fee was taxable in India as FTS under the provisions of the Act.

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TRANSFER PRICING

I. Delhi High Court holds research and information service as KPO.

(Mckinsey Knowledge Centre India (P.) Ltd. [2018] 96 taxmann.com 237 (Delhi))

Recently, the High Court of Delhi upheld characterization of Research and Information ('R&I') segment of assessee as Knowledge Process Outsourcing ('KPO') by Tax Tribunal against the assessee's contention of characterising it as Business Process Outsourcing ('BPO'). Furthermore, the transfer pricing addition on account of interest on outstanding receivables from associated enterprises ('AE') was also upheld.

On the facts of the case, the assessee is a wholly owned subsidiary of McKinsey Holding Inc., USA and primarily operates in two business divisions – (a) R&I services and (b) IT

support services. During the relevant year, the assessee entered into certain international transactions with its AEs and choose Transaction Net Margin Method ('TNMM') as most appropriate method to justify arm's length price ('ALP') by using Operating Profit/ Operating Cost as profit level indicator ('PLI'). The Transfer Pricing Officer ('TPO') accepted the method and PLI adopted by assessee, however, rejected certain comparable selected by assessee and proposed addition in relation to transactions of R&I services and IT support services. The TPO also made adjustment on account of interest on outstanding receivables from AEs. Aggrieved, the assessee filed objections before Dispute Resolution Panel ('**DRP**').

The DRP rejected assessee's objection against functional comparability of comparable selected by TPO and directed the TPO to apply export filter and exclude comparable which fail export filter. Aggrieved, the assessee filed appeal before the Tax Tribunal.

The Tax Tribunal characterised the R&I services as KPO services, directed exclusion of certain comparable on functional dissimilarity and upheld addition on account of interest on outstanding receivables from AEs. Upon appeal, the High Court of Delhi held as under:

a. Characterisation as KPO versus BPO

The assessee contended before High Court that R&I services rendered by it were in the nature of customization of data/data processing and it acts as a "back office" providing "support services" to its parent company and relied upon the Tax Tribunal decision in its own case of AY 2006-07, decision of High Court of Delhi in the case of Rampgreen Solutions (P) Ltd v. CIT 60 Taxmann.com 255 (Del) and the definition of BPO services provided by CBDT under Rule 10TA of the Income-tax Rules. The Revenue argued that the assessee is engaged in the business of high skilled advisory services which requires not only analysis of specialized data but also involves analysis, processing, customization, interpretation of data and creation of knowledge bank.

The High Court referred to the Master Services Agreement entered by assessee with its AE and observed that the assessee's functions are inclusive of Knowledge management systems. Also, as per Tribunal's order there is clearly a form of knowledge intensive analysis that is rendered by the Assessee which is a more nuanced and involved service than that which is provided by a BPO. Therefore, the High Court held that the services rendered by the assessee are specialized and require specific skill-based analysis and research that is beyond the more rudimentary nature of services rendered by a BPO and more akin to a KPO. Accordingly, the appeal of the assessee was dismissed.

b. Interest on outstanding AE receivable

The assessee contended that realisation of sale/ service proceeds is incidental to the transaction of sale / service, thus if ALP in respect of international transaction is determined, then there can be no question to benchmark the interest separately. In this regard, the High Court referred to the amendment brought under Explanation to Section 92B of the Act vide Finance Act, 2012 and held that if there is any delay in the realization of a trading debt arising from the sale of goods or services,

transfer pricing adjustment on account of interest is warranted. Accordingly, the appeal of the assessee was dismissed.

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DOMESTIC TAXATION

I. Interest paid for obtaining loans for giving non-interest bearing advances is allowable

(PCIT Vs. Reebok India Company)[TS-588-HC-2018(DEL)]

(PCIT Vs. The Basti Sugar Mills Company Limiteed)[TS-619-HC-2018(DEL)]

The Hon'ble High Court of Delhi in a recent decision has held that no disallowance under section 36(1)(iii) of the Income Tax Act is called for with respect to the interest paid on unsecured loans, which were unutilized for giving non-interest bearing advances to third parties.

In the instant case, Reebok India Company ('the assessee') had paid interest amounting to INR 68.75 crores on unsecured loans of INR 502.69 crores. The assessee on the other hand had also provided non-interest bearing advances amounting to INR 172.59 crores to third parties. The Assessing Officer ('AO') disallowed proportionate interest of INR 23.60 crores, to the extent of advances granted to third parties.

When the matter travelled to High Court, the Hon'ble court noted the observation of the Tribunal that the funds were utilized for business purposes and thereafter in such a case, there cannot be any disallowance under section 36(1)(iii) of the Act.

The Hon'ble High Court, further, also referred to the judgment of S.A. Builders Ltd. V. CIT, [(2007) 1 SCC 781] wherein it was explained that the term "for the purposes of business and profession" used in section 36(1)(iii) is wider in scope than "for the purpose of earning income, profits or gains". Accordingly, High Court held that expenditure meeting the commercial expediency test is to be allowed and it is immaterial if a third party also derives benefits from such the expenditure.

The High Court also held that commercial expediency test is satisfied even if interest free advances are granted to third parties, so long as the same are connected to the business and not for personal benefits. As such, if a nexus with the business does exist, such expenditure shall be allowable as a deduction.

A similar issue has also been dealt by the Hon'ble High Court of Delhi in the case of Basti Sugar Mills Company Limited, wherein such company had provided interest free advances to its sister concern. The HC held that interest on loans shall be allowed as a deduction under section 36(1)(iii) of the Act, even if advances had been provided to sister concern. On the facts of such case, the High Court held that the test of commercial expediency was met and that it was in relation to furtherance of business.

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II. Letting out terrace to mobile operator for operation of mobile tower is 'Income from House Property'

(Kohinoor Industrial Premises Co–operative Society Ltd. v. ITO ITA no.670/Mum./2018)

The Mumbai Bench of Tax Tribunal has held that the rental income received by the assessee from cellular operator for letting out terrace for installation of mobile tower is income from house property.

The assessee argued that the income from letting out of the terrace of the housing society for installation/ operation of mobile towers ought to be characterized as Income from House Property. However, this contention was rejected by the Assessing Officer, who held that such income must be regarded as Income from Other Sources. Furthermore, the CIT(Appeals) observed that the said receipt was merely a compensation for provision of a facility to cellular operator and should be treated as Income from Other Sources.

Upon examination of the facts, the Tax Tribunal held as follows –

- That the terrace of the building which was let out by the assessee, cannot be considered as distinct and separate but certainly is a part of the house property.
- That no evidence was adduced to demonstrate that any other service or facility was provided to the cellular operators, in addition to letting–out space on the terrace. Therefore, the income received by the assessee is purely on account of letting out space on the terrace.

- That during earlier years, the assessee's claims of such income as house property had never been objected by the revenue authorities, thus, applying rule of consistency also, assessee's claim deserved to be allowed.

In view of above, the Tax Tribunal observed that the receipts from cellular operator for installation of mobile tower should be treated as income from house property rather than income from other source. Hence, the assessee was eligible for standard deduction of 30% in terms of the computation provisions pertaining to Income from House Property.

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III. Amendments in Forms 36 / 36A for filing appeals / cross objections before the Tax Tribunal

The CBDT has issued final rules to substitute old Forms 36 / 36A for filing appeal before the Income Tax Appellate Tribunal, to inter-alia capture additional details viz PAN & TAN of the appellant and respondent, amount of addition / disallowance made in the assessment, amount disputed in appeal and tax payable in respect of the same, details of pending appeals at the Tax Tribunal, amount disputed in appeal or cross objections.

Further, as per a separate Notification No. 73/2018, it has been provided that any appeal before the Tax Tribunal against the order of DRP shall also be filed in Form 36 instead of Form 36B.

IV. Amendment in Form 13 for filing of application by a person for a certificate under section 197 or under section 206C(9), for no deduction of tax or deduction or collection of tax (TDS/TCS) at a lower rate

The CBDT has issued a Notification No. 74/2018 dated October 25, 2018 amending Rule 28AA related to application for certificate for deduction of tax at lower rates and Rule 37G related to application for certificate for collection of tax at lower rates under section 206C(9). As per the amended rule 28AA, the certificate for deduction of tax at any lower rates or no deduction of tax, as the case may be, shall be issued direct to the person responsible for deducting the tax under advice to the person who made an application for issue of such certificate. However, where the number of persons responsible for deducting the tax is likely to exceed one hundred and the details of such persons are not available at the time of making application with the person making such application, the certificate for deduction of tax at lower rate may be issued to the person who made an application for issue of such certificate, authorising him to receive income or sum after deduction of tax at lower rate. Further, the application by a person in Form 13 shall be made electronically under digital signature or through electronic verification code.

Similarly, the revised Rule 37G provides that an application by buyer or licensee or lessee for a certificate under section 206C(9) shall be made in Form No. 13 electronically under digital signature or through electronic verification code.

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CORPORATE LAW

I. Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2018

The MCA vide Notification No. S.O. 3921(E) dated 07th August 2018 has notified relevant provision of Companies Amendment Act 2017 w.e.f. 07th August 2018 which has led to revision in Section 42 dealing with private placement of securities.

Simultaneously the MCA vide Notification No. G.S.R. 752(E) dated 07th August 2018 has notified Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2018 [hereinafter referred to as "amendment rules"] in order to amend the Companies (Prospectus and Allotment of Securities) Rules, 2014, which have come into force with effect from 07th August 2018 .

The significant changes brought out by the revised section and the amendment rules are as under:

- The revised provision contains a new provision which states that the private placement offer and application shall not carry any right of renunciation
- The revised provision contains a new embargo which states that the company can utilize the monies raised through private placement only after filing of return of allotment with ROC. It is pertinent to note here that the revised section has also curtailed the period of filing of return of allotment from 30 days to 15 days.
- Earlier, penalty @ Rs 1000 for each day during which the default continues or Rs 1 lac whichever is less was provided for the company and its officers in default for non-filing of return of allotment. Now, for non-filing of return of allotment within prescribed time of 15 days, along with the company and directors, the promoters shall also be liable to penalty @ Rs 1000 for each day during which the default continues not exceeding Rs 25 lakhs.
- As per the amended rules, certain additional disclosures are now required to be inserted in the explanatory statement, annexed to the notice convening the general meeting, for obtaining prior approval of shareholders.
- As per the amendment rules, for public companies the requirement of obtaining prior shareholders' approval in case of offer of Non-convertible debentures [NCD] has been dispensed with, provided that the amount proposed to be raised along

with the existing borrowings does not exceed the limit provided in Sec 180(1)(c) i.e. aggregate of Paid up capital, free reserves and securities premium account. In these cases, board resolution passed under Sec 179(3)(c) for issuance of securities will suffice. And, only in case where the proposed issue of NCD along with the existing borrowings is surpassing Sec 180(1)(c) limit, prior shareholders' approval by way of special resolution would be required. The private companies are required to seek prior shareholders' approval for issue of NCD.

- Currently, one of the conditions of private placement offer specifies that the payment needs to be made from the bank account of the person subscribing to such securities and the company was supposed to keep the record of such bank account. Now, it has been clarified that this condition will not apply in case of securities for consideration other than cash.
- The amendment rules contains a new restriction which states that private placement offer cum application letter shall be issued only after relevant Board resolution passed under Sec 179(3)(c) or Special resolution passed under Section 42 has been filed with ROC.

II. Companies (Registered Valuers and Valuation) Third Amendment Rules, 2018

The MCA vide Notification No. G.S.R. 925(E) dated 25th September 2018 has notified Companies (Registered Valuers and Valuation) Third Amendment Rules, 2018 [hereinafter referred to as "amendment rules"] in order to amend the Companies (Registered Valuers and Valuation) Rules, 2017, which have come into force with effect from 26th September 2018. For making transitional arrangements currently the rules specifies that any person who is hitherto rendering valuation services can continue to render those services without obtaining registration certificate under these rules up to 30th September 2018. Now, the amendment rules have extended this time till 31st January 2019.

III. Extension of last date of filing of financial statements and annual return

The Ministry of Corporate Affairs [MCA] vide General Circular No. 10/2018 issued on 29th October, 2018 has extended the time for filing of financial statements of F/Y 2017-18 in 'xbrl' mode, non 'xbrl' mode, consolidated financial statements as well as annual return upto 31st December, 2018, without levying additional fees.

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REGULATORY

I. India jumps 23 points in Ease of Doing Business Rankings

India has joined the 100 nations club in 'Ease of Doing Business Rankings' as per a latest survey of the World Bank. India has jumped 23 places from its last year position of 100 to the 77th position.

The parameters on which India recorded significant improvement include ease of starting business, construction permits, getting electricity, getting credit, paying taxes, trade across borders, enforcing contracts and resolving insolvency.

This development comes as a big boost to the Modi led Government which shall be contesting the General Elections in 2019.

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IMPORTANT

DATES TO REMEMBER

Particulars	Date
Deposit of TDS for the month of November 2018	07.12.2018
Date of deposit of GST and filing of GSTR-3B for the month of November 2018	20.12.2018
Filing of GSTR I for the month of November 2018	11.12.2018

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