MOHINDER PURI & CO.
CHARTERED ACCOUNTANTS

Corporate Update

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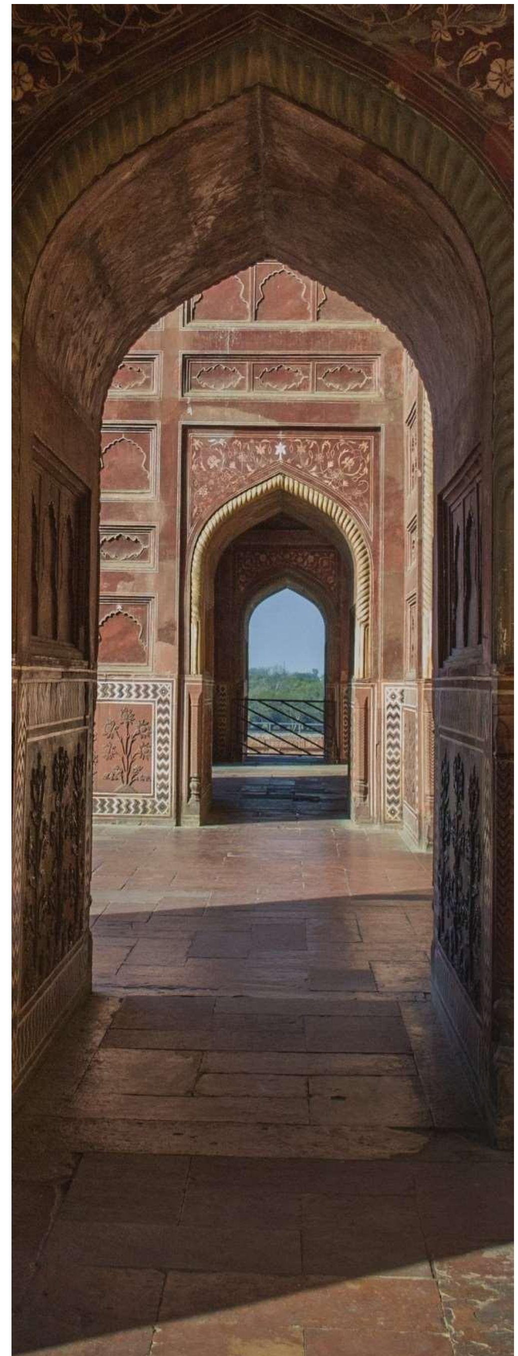

FOREWORD

Dear Reader,

The Union Budget 2019 was announced by the Finance Minister, Ms. Nirmala Sitharaman on July 5, 2019. In her budget speech, the Finance Minister laid out the vision of the Government, which focuses on infrastructure development, providing impetus to start ups, digitalization of the economy and improving standards of health.

On the direct tax front, the Finance Minister highlighted that direct tax collections have increased by 78% since the financial year 2013-14. Furthermore, the Government has continued the phased reduction of tax rates for domestic companies. Upto the financial year 2018-19, the concessional tax rate of 25% was applicable for domestic companies having turnover not exceeding INR 250 crores (Roughly Euro 31 Million). The said monetary threshold is proposed to be enhanced to INR 400 crores (Roughly Euro 50 Million).

The Finance Ministry has also proposed to increase the rate of surcharge applicable for super rich individuals, i.e. having income of more than INR 2 crores (Roughly Euro 250 Thousand).

To promote its 'Make in India' initiative, the Finance Ministry has also proposed tax sops for advanced technology manufacturing, such as semi-conductors, solar photo voltaic cells, solar electric charging infrastructure etc.

A key highlight of the union budget is that the Government has promised to resolve the 'angel tax controversy' (taxation of share premium at the time of capital infusion in start-ups) that had prevailed for quite some time. As such, if the start-ups and their investors file the requisite declarations and information, the valuations of share premium shall not be questioned by the tax authorities after due verification of the identity and sources of the investor.

A special Budget Edition capturing the key highlights of the Union Budget shall be circulated shortly.

C.S. Mathur
Partner

International Tax

India deposits instrument of ratification of MLI with the OECD depository

URL:https://www.oecd.org/ctp/treaties/latest documents/

On June 12, 2019, the Union Cabinet had approved ratification of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) which was signed by India on June 07, 2017. On June 25, 2019, India deposited its instrument of ratification (with list reservation & notifications) with the OECD, being the depository of the MLI.

In terms of Article 34 of the MLI, the same shall enter into force after three calendar months from the date of deposit of the ratified instrument with the OECD. As such, the date of entry into force for India shall be October 01, 2019.

The MLI does not apply to all the tax treaties of signatories, but only to those where both the parties to a tax treaty have notified their bilateral tax treaty to be covered. Such treaties are known as Covered Tax Agreements (CTAs).

However, the date of entry into effect of such MLI in respect of a particular CTA, shall depend on the date when the necessary formalities are completed by the treaty partner.

Based on the mechanism of determining the effective date of applicability as provided in the MLI, the provisions of MLI with respect to following 23 Indian treaties (where formalities were completed on or before June 30, 2019) shall be effective from FY 2020-21: -

1. Australia
2. Austria
3. Belgium
4. Finland
5. France
6. Georgia
7. Ireland
8. Israel
9. Japan
10. Lithuania
11. Luxembourg
12. Malta
13. Netherlands
14. New Zealand
15. Poland
16. Russian Federation
17. Serbia
18. Singapore
19. Slovak Republic
20. Slovenia
21. Sweden
22. United Arab Emirates
23. United Kingdom

ITAT rules out constitution of PE in respect of gem grading services rendered to a group company based in India

Gemological Institute of America, Inc. Vs ACIT [2019] ITA No. 1138/Mum/2015

The Hon'ble Tax Tribunal, Mumbai Bench ruled out constitution of fixed place PE, agency PE or service PE, for a US company, engaged in gem grading service.

On facts, the assessee was a tax resident of USA engaged in the business of diamond grading services. During the relevant year, the assessee rendered gem grading services to its Indian subsidiary. Such services were generally availed by the Indian company from various group entities in case of resource/technical constraint. During the scrutiny proceedings, the Assessing Officer concluded that transactions between assessee and its Indian group Company was in the nature of joint venture arrangement and the assessee had a fixed place/agency PE/Service PE in India.

On appeal, the Hon'ble Tax Tribunal decided the issue in favour of the assessee and held as under:

1. *Fixed Place PE*- The Indian subsidiary was an independent entity, having its own expertise in gem grading services, and as such, the arrangement with the assessee was not a joint venture, rather a sub-contracting of grading activity where various risks under the transaction such as credit risk, client facing risk etc. were borne by the Indian subsidiary. Mere fact that the assessee had controlling interest in Indian company, did not render Indian subsidiary as a 'fixed place PE' of the assessee in terms of Article 5(6) of the Indo-US tax treaty.

2. *Service PE*- The grading services were rendered outside India and no employee had travelled to India as such, incidence of service PE was not triggered in terms of the provisions of tax treaty.

3. *Agency PE*- The Indian Company was carrying on its business as an independent entity and had borne various risks in respect of stones sent to the assessee for grading purpose. FAR analysis as recorded in Transfer Pricing study report of Indian subsidiary was accepted by the Transfer Pricing Officer in its case as well as in the assessee's case. The Indian subsidiary neither had any authority to conclude contracts nor did it conclude/ secure orders on behalf of the assessee. As such, the Indian Company could not be regarded as Agency PE of the assessee in India in terms of Article 5(4) and 5(5) of Indo-US tax treaty.

Executive Search Fees not FTS/Royalty under India-Netherlands tax treaty, reliance placed on APA with Indian Associated Enterprise

Spencer Stuart International BV [TS-333-ITAT-2019(Mum)]

Recently, the Hon'ble Tax Tribunal, Mumbai bench, in the case of Spencer Stuart International BV ('the assessee') held that Executive Search Fees (ESF) was not taxable in India as Fees for Technical Services (FTS) or Royalty under Article 12 of the India-Netherlands tax treaty.

On facts, the assessee is a Dutch Company and had the following two streams of income from its wholly owned Indian subsidiary, Spencer Stuart (India) Pvt Ltd (SS India):

1. License fee earned under the License Agreement, which was offered to tax as royalty. The license was granted to SS India for use of trademark and software owned by the assessee and certain support services. The assessee received a license fee computed at 13.5% of the net revenue of SS India.

2. ESF earned under the Service Agreement, which was claimed as business profits not taxable in absence of Permanent Establishment ('PE') in India.

The Assessing Officer ('AO') held that ESF was taxable as FTS/Royalty under Article 12 of the tax treaty.

On appeal, the Tribunal relied on co-ordinate bench decision in assessee's own case for earlier year wherein it was held that ESF was not taxable in India as FTS as the same was not ancillary and subsidiary to license fee received for the use of property rights. The core business of the group was to identify, evaluate and recruit senior personnel for a fee. As per the Service Agreement, search fees were to be determined on the basis of relative contribution of each party, which meant in a given situation, SS India could

also have received search fees from the assessee. However, the same was not applicable for license fee. The two agreements were distinct and separate and license fees payable by SS India was percentage of ESF earned by it. Furthermore, services ancillary and subsidiary to the use of license/trademark/software were provided for in the License Agreement and same had no correlation with the Service Agreement. Also, the 'Make available' condition was also not fulfilled for such ESF to qualify as FTS under Article 12 of the tax treaty.

The coordinate bench had also relied on the Advance Pricing Agreement ('APA') with SS India wherein, after detailed Functions, Assets and Risk ('FAR') analysis, separate benchmarking for license fee and ESF was laid down, being Profit Split Method for ESF and Comparable Uncontrolled Price for license fees.

The Tribunal observed that the aforementioned APA covered the Assessment Year ('AY') as well as the transactions under consideration and remarked that even if the Revenue contended that the ESF is nothing but license fee (i.e. Royalty) then also in the APA proceedings, the Revenue had to re-characterize such ESF as 'license fee'.

The Tribunal held that if the present view of AO was accepted, it would render the APA redundant.

Accordingly, the Tribunal concluded that ESF was neither taxable as FTS nor as Royalty.

Tribunal interprets Article 12(5) of Finland treaty, holds income from testing services not taxable as FTS

Outotec (Finland) Oy [TS-311-ITAT-2019(Kol)]

The Hon'ble Tax Tribunal, Kolkata bench, in the case of Outotec (Finland) Oy, inter-alia held that income earned by a Finnish Co. from rendering of testing and other services outside India in connection with its Indian Projects constituted FTS under India-Finland tax treaty for AY 2015-16.

Generally speaking, FTS is taxed in the country where such services arise, regardless of the situs of rendition of such services. However, as regards Article 12 of the Indo-Finnish tax treaty, which was the subject matter in question in the instant case, the language employed is peculiar and has additional provision as compared to corresponding text of the OCED/UN Model Tax Convention. The said Article 12(5) of the Indo-Finnish tax treaty reads as under:

"*Where, however, the right or property for which the royalties are paid is used within a Contracting State or the FTS relate to services performed, within a contracting State, then such royalties or FTS shall be deemed to arise in the state in which the right or property is used or the services are performed*".

Based on the aforesaid provision, the assessee argued that the FTS in the instant case arises in Finland, as the services were performed in Finland and hence not taxable in India.

The Tribunal, while rejecting this argument, held that the aforesaid clause did not apply as the payment in question was made for test results which were used within India. The Tribunal explained that though the process of testing may have been conducted outside India but the payment in question was not for the process but was for the results of testing which were used in India. Thus, the Tribunal held that the payments were liable to tax as FTS.

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Domestic Taxation

Bonafide expenditure for unapproved fund created for the benefit of the employees is an allowable expenditure

PCIT Vs State Bank of India [ITA No. 718/2017 Bombay High Court]

In terms of Section 40A(9) of the Act, only such contributions to funds etc are admissible which are made to approved/recognised funds as referred in Section 36(1) (iv) and Section 36(1)(v) of the Act or any other fund statutorily required under any other Act.

The Hon'ble High court of Bombay in a recent decision held that the expenditure incurred by the assessee towards contribution to a fund created for the health care of the retired employees was genuine and as such does not attract disallowance under the provisions of Section 40A(9) of the Act.

In the instant case, the assessee has made a contribution of Rs. 50 lacs towards a fund created for the health care of the retired employees and claimed the same as deduction as Business expenditure under section 28 of the Act. The Assessing Officer disallowed the expenditure under section 40A(9) on the premise that such fund was not recognized under Section 36(1)(iv) or (v) of the Act.

The Tribunal placed reliance on the explanatory notes on the provisions contained in Finance Act 1984 in the context of insertion of Section 40(A)(9) wherein it has been stated that genuine expenditure incurred shall not be hit by the provisions of Section 40A(9). The tribunal held in favour of the assessee as there was no doubt on the *bonafides* in relation to the creation of the fund in the present case.

Upon further appeal, the Hon'ble High court observed that Section 40A(9) of the Act, was inserted to discourage the practice of creation of bogus funds, trusts, association of persons and not to disallow genuine expenditure for welfare of its employees. Furthermore, as the *bonafides* of the transaction was proved, the High Court held that disallowance under Section 40A(9) was not attracted in this case.

Discount earned on FCCB buyback, not taxable

DCIT Vs M/s. Pidilite industries Ltd. [ITA No. 7351/mum/2017 and 7352/mum/2017]

The Mumbai Bench of the Tribunal has held that discount earned by the assessee ('Pidilite Industries') on buyback of Foreign Currency Convertible Bonds [FCCBs], issued for meeting capital expenditure, cannot be taxed under the provisions of section 28(iv) of the Income-tax Act. Section 28(iv) deals with the taxation of the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession as profits and gains from business and profession (PGBP).

In the instant case, the assessee, during FY 2007-08 issued FCCBs worth US $ 40 million in foreign currency, primarily for meeting capital expenditure and funding international acquisitions. Although the FCCBs were to mature in FY 2012-13, certain portion of the FCCBs were bought back in FY 2009-10(AY 2010-11), after seeking permission from RBI. Upon buyback, the assessee earned a discount.

The Assessing Officer, while invoking the provisions of Section 28(iv) of the Income-tax Act held such discount to be income taxable in the hands of the assessee, by relying on the Bombay High court decision in the case of *Solid Containers v DCIT 178 taxman 192*. The Commissioner of Income tax (Appeals), deleted the aforesaid addition by observing that in terms of the RBI circular, the proceeds of FCCBs could only be used for capital purposes and not for working capital, general corporate or existing loan repayments. As such, the discount on repurchase cannot be termed as gains envisaged by Section 28(iv).

Aggrieved by the order of CIT(A), the revenue preferred an appeal before the Tribunal. The Tribunal observed that a benefit, in order to be taxed under section 28(iv), has to be in some form, other than in the shape of money. In the instant case, the discount which is earned is in the form of money. Therefore, in view of the decision of Hon'ble Supreme Court in case of Mahindra and Mahindra **93 Taxmann.com 32** and decision of Bombay High Court in **CIT Vs Xylon Holdings Pvt Ltd 211 Taxman 108**, the Mumbai Tribunal held that the discount could not be regarded as income under Section 28(iv) and thus deleted the addition.

Definition of intangible asset wide enough to include the scope of non-compete fees and hence depreciation allowable

PCIT Vs Piramal Glass Limited [ITA No 556/2017]

The Hon'ble High Court of Bombay has held that the non-compete fee paid falls in the definition of an intangible asset under Section 32(1)(ii) of the Income-tax Act and hence depreciation can be claimed on the same.

In the instant case, Piramal Glass Limited ('the assessee') claimed depreciation on the non-compete fees paid by it on acquisition of the glass division of another company. However, Revenue had disallowed the same on the grounds that depreciation can be claimed only when the same is covered in Explanation 3 to Section 32(1)(ii) of the Income-tax Act which provides that intangible assets include know-how, patents, copyrights, trademarks, licenses, or any other business or commercial rights of similar nature.

The Hon'ble High Court of Bombay, while deciding the issue relied on the decision of Division Bench of the Gujarat High Court in the case of *PCIT vs. Ferromatice Milacron India (P.) Limited 99 taxmann.com 154,* wherein it was held that non-compete fee paid to an erstwhile partner for not soliciting customers or employees and to ward off the competition is capital in nature and depreciation is allowable on the same. The Gujarat HC also placed reliance certain other decisions wherein it was held that the words "business or commercial rights of similar nature" of Section 32(1)(ii), as inserted by the legislature were intended to provide depreciation also on such categories of intangible assets, which are not possible to enumerate.

The Hon'ble High Court of Bombay in the light of the earlier decision of Gujarat High Court, dismissed the appeal of the Revenue.

It may be mentioned that with respect to the non-compete fees, there are conflicting decisions that whether the same is capital or revenue in nature. Further, even if the same is considered as capital in nature, whether depreciation can be claimed on the same as intangible is another contentious issue. In the decision of the High Court of Delhi in the case of *Sharp Business Systems 27 taxmann.com 50*, although the non-compete fee was held to be capital in nature, depreciation thereon was denied as the same could not be characterized as an intangible asset. The Hon'ble High Court held that an intangible asset would cover the rights which are enforceable against the world at large and that the nature of non-compete fee is different.

In this backdrop, the eligibility of depreciation on non-compete fee continues to remain a vexed issue.

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Transfer Pricing

Reimbursement of charter-hire charges is an international transaction and requires benchmarking

Synefra Engineering & Construction Ltd [TS-542-ITAT-2019 (Ahd)-TP]

In a recent judgement, Hon'ble Tribunal, Ahmedabad Bench, held that the reimbursement of charter hire charges by Associated Enterprise ('AE') to the Assessee is an international transaction under of transfer pricing provisions and accordingly, is required to be benchmarked by the Assessee.

On the facts of the case, the Assessee, amongst other business activities, is engaged in the business of shipping. It entered into a time charter contract with an unrelated party in India and instead of using the vessel on its own, allowed its AE to use the vessel on the same terms (including the price) on back to back basis. The invoices, however, were raised in the name of the Assessee which were paid by the AE at actual cost without any mark-up and the Assessee merely passed memorandum entries in its books of accounts.

The aforesaid transaction of reimbursement of charter hire charges was referred by the AO to Transfer Pricing Officer ('TPO'). The TPO on examination noticed that the Assessee and its AE have shown different margins from the business of shipping i.e. the AE has earned margin of 16.42% vis-à-vis 4.43% by the Assessee. The Assessee explained that variation was on account of strategic location of the AE at Singapore, which is a shipping hub, and high margins are earned by the AE from independent transactions. The TPO however noted that most of the transactions of the AE are with its related party and the Assessee has not been able to demonstrate transaction wise that AE has earned high profits from transactions with independent parties.

The TPO was of the view that Assessee had performed crucial functions as it had negotiated the contract, the contract has been entered in its name and risk has been assumed by the Assessee as the billing is done in its name. The TPO also observed that the only function performed by AE was of payment of cargo and documentation.

Based on the aforesaid functional, assets and risks analysis the TPO attributed 80% of the actual profit earned by AE, in respect of these transactions to the Assessee and made Transfer Pricing adjustment.

The Assessee filed an appeal before the Commissioner (Appeals). The Commissioner (Appeals) also held that the impugned transaction is an international transaction, however, with respect to arm's length analysis he adopted 7.5% as mark-up which should have been charged by the Assessee, on the basis of the presumptive taxation scheme under section 172 of the Income-tax Act applicable for non-resident ship operators.

Against the above appellate order, both the tax authorities and the Assessee filed an appeal before the Tribunal. Before the Tribunal, the Assessee contended that such impugned transaction is not an international transaction as these are merely memorandum entries as the bills raised by shipowners are simply forwarded to the AE. The Tribunal did not approve such argument of the Assessee and held that actual earning of profits or incurring of losses in a transaction is not a *sine qua non* for transaction being treated as 'international transaction', it is "having the bearing" on profit and losses which is sufficient for the transaction being treated as international transaction. The Tribunal thus held that the transaction in question is an international transaction which should have been benchmarked by the Assessee.

Regarding benchmarking, the Tribunal held that the transaction entered by the Assessee with the third party and subsequently with the AE on back to back cases would have been comparable with the price at which transaction was entered with the third party where no functions were performed, assets employed or risk was assumed by the Assessee. However, in the instant case the

Assessee had performed the function of negotiating the contract with the ship owner. Accordingly, an adjustment for such function should be made in the transaction value. Further, the Tribunal held that while entire estimate profit of operation of ships by the foreign companies is 7.5% under the presumptive taxation scheme under Section 172, the adjustment for the function of negotiating the contract must remain restricted to a small part of this overall reasonable estimated income. With these directions the matter was remitted back to the Transfer Pricing Officer.

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Goods and Services Tax

Recent Updates

The Council has recommended to introduce electronic invoicing system in a phase-wise manner for B2B transactions. The Phase 1 is proposed to be voluntary and it shall be rolled out from January, 2020.

GST Council Recommendations on GST Returns:

- Between July 2019 to September 2019, the new return system (**FORM GST ANX-1 & FORM GST ANX-2**) to be available for trial for taxpayers. Taxpayers to continue to file FORM GSTR-1 & FORM GSTR-3B as at present;

- From October 2019 onwards, **FORM GST ANX-1** to be made compulsory. Large taxpayers (having aggregate turnover of more than Rs. 5 crores in previous year) to file FORM GST ANX-1 on monthly basis whereas small taxpayers to file first FORM GST ANX-1 for the quarter **October, 2019 to December, 2019** in January, 2020;

- For October and November, 2019, large taxpayers to continue to file FORM GSTR-3B on monthly basis and will file first **FORM GST RET-01** for December, 2019 in January, 2020. It may be noted that invoices etc. can be uploaded in FORM GST ANX-1 on a continuous basis both by large and small taxpayers from October, 2019 onwards. **FORM GST ANX-2** may be viewed simultaneously during this period but no action shall be allowed on such FORM GST ANX-2;

- From October, 2019, small taxpayers to stop filing FORM GSTR-3B and to start filing **FORM GST PMT-08**. They will file their first FORM GST-RET-01 for the quarter October, 2019 to December, 2019 in January, 2020;

- From January, 2020 onwards, FORM GSTR-3B to be completely phased out;

- CBIC has vide order number **06/2019-Central Tax** dated June 28, 2019, for extending the due dates for furnishing annual returns in FORM GSTR-9, FORM GSTR-9A and reconciliation statement in FORM GSTR-9C, till 31st August, 2019;

- Government vide **Notification No. 32/2019 dated 28th June, 2019**, has extended due date for furnishing declaration in Form GST ITC-04, in respect of goods sent to or received from Job workers for the period July 2017 to June 2019 up to 31st August, 2019;

- Rule 138E of the CGST rules, pertaining to **blocking of e-way bills** on non-filing of returns for two consecutive tax periods, to be brought into effect from 21st August 2019, instead of the earlier notified date of 21st June 2019;

- Last date for filing of intimation, in FORM GST CMP-02, for availing the option of

payment of tax under notification No. 2/2019 – Central Tax (Rate) dated **7th March 2019**, extended from 30th April, 2019 to 31st July 2019;

- Government has vide **Notification No. 26/2019** dated 28th June 2019, extended the due date for furnishing GSTR-7 under Section 51 for the month of October, 2018 to July, 2019 till the 31st day of August, 2019;

- Government has vide **Notification No. 30/2019 dated June 28, 2019**, provided exemption from furnishing of Annual Return / Reconciliation Statement for suppliers of Online Information Database Access and Retrieval Services **("OIDAR services")**;

- In order to ease the current process of GST registration and reduce the paperwork involved, GST Council has given a go-ahead to a new system for verification of taxpayers registering themselves under GST. **Aadhaar number** shall be linked to the GSTIN while generation;

- Among other major decisions, the GST Council approved the **electronic ticketing system, for multiplexes**, having multi-screens. This will help curb cases of tax evasion and the use of black tickets that have been prevalent.

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Important dates to remember

Particulars	Date
Filing of TDS Return for quarter ended June 2019	31.07.2019
Deposit of TDS for the month of July 2019	07.08.2019
Filing of GSTR I for the month of July 2019	11.08.2019
Filing of GSTR 3B for the month of July 2019	20.08.2019

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