MOHINDER PURI & CO.
CHARTERED ACCOUNTANTS

Corporate Update

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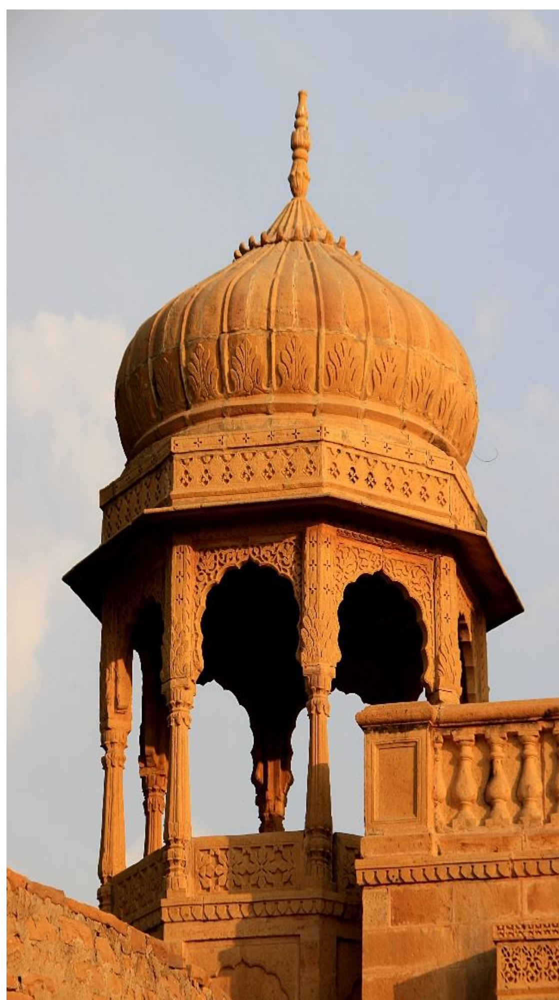

FOREWORD

Dear Reader,

Several changes in the Limited Liability Partnership Act were notified last month by the Ministry of Corporate Affairs, Government of India. The changes aim mainly at decriminalising existing penalty provisions applicable for defaults committed in various compliances by LLP's, its partners. Certain defaults will now attract only monetary penalties. LLP is now a preferred entity for small business and professional firms.

The Government further extended certain Income-tax compliance dates, this time due to technical difficulties faced by taxpayers in accessing the new portal launched by the Central Board of Direct Taxes, Ministry of Finance.

In addition, we cover in this update a few changes in regulations applicable to insurance companies besides a few important decisions on international taxation, transfer pricing etc.

C.S. Mathur
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DIRECT TAX
International Taxation

Tribunal holds accurate cost allocation imperative for determining Arm's Length Price (ALP) of services availed of and for segment profitability

Lear Automotive India P Ltd [TS-325-ITAT-2021(PUN)-TP

In a recent judgement, the Tax Tribunal, Pune Bench held that in respect of services availed of from an Associated Enterprise (AE) in addition to justifying the margin charged by the AE, the accuracy of the cost allocated by the AE is also required to be checked. Further, the Tribunal held that the comparable should be functionally similar and from similar geographical location. Also, the Tribunal rejected the segment profitability prepared by the assessee for benchmarking in view of the incorrect cost allocation.

On the facts of the case the assessee is engaged in the business of manufacturing/ assembly of automotive seating and electrical systems along with design and engineering support services. For the relevant year, the case of the assessee was selected for transfer pricing assessment for determination the arm's length price (ALP). The TPO made adjustments in respect of a) allocation of Regional Head Quarter (RHQ) costs, b) under the Manufacturing Activity segment and c) payment for Global Software charges.

a) *Adjustment in respect of allocation of RHQ Costs* – The AE of the assessee, Lear Shanghai provided support services to the worldwide group entities including the assessee and allocated cost of such services (RHQ cost) after adding a mark-up of 5%. The assessee benchmarked the said transaction using TNMM and considering Lear shanghai as tested party. However, the TPO determined the ALP of RHQ cost at Nil by holding that the assessee did not prove availing of any RHQ services. The TPO also rejected selection of the AE as tested party.

Before the Tribunal, the assessee referred to the copy of the agreement entered with AE enlisting various services availed of and also provided the e-mail and other communications evidencing availment of services from the AE. The assessee placed reliance on judgement of Hon'ble Madras High Court in Virtusa Consulting Services Private Ltd. Vs. DCIT (124 taxmann.com 309) along with OECD guidelines and UN Manual contending that tested party should be the least complex entity and as such, AE should be accepted as tested party. To substantiate, assessee outlined the cost allocation structure of the AE backed by auditor's certificate which involves the division of cost centres into cost pools followed by cost codes along with the bifurcation of beneficiary. These costs were allocated on the basis of time spent by work force.

The Tribunal observed that high percentage of time allocated to the assessee is not substantiated by auditor's report and stated that benchmarking requires not only a mark-up in the international transaction which is comparable with uncontrolled transactions but also an accurate cost allocation. Accordingly, holding that the cost allocation by the AE is arbitrary and unsubstantiated, the Tribunal held that the functions of the AE are complex vis-à-vis the assessee's and as such, the assessee should be used as the tested party.

The Tribunal further proceeded to examine the correctness of comparable selected by the assessee. The assessee has used Japanese companies as comparable. The Tribunal rejected such comparable holding that the location of comparables plays a

significant role in making comparison. Thus, the matter was remanded back to AO/ TPO for redetermining the ALP of the transactions by taking assessee as a tested party.

b) *Adjustment under Manufacturing Activity segment* – The manufacturing segment of the assessee consisted of three transactions i.e., Export of seating components, Import of CKD components and import of raw materials and components. These transactions were independently benchmarked by the assessee using TNMM as MAM. The TPO rejected the splitting of accounts and benchmarked the aforesaid transactions by taking the overall manufacturing unit as one unit, thus making an adjustment.

The Tribunal observed that to compute segment profitability, cost has been apportioned on actual basis as well as on the basis of ratio of net revenues. The Tribunal found such apportionment done with the intent of projecting higher operating profit in relation to segment of international transactions. The assessee placed reliance on the decision of Kolkata Bench of the Tribunal in DCIT Vs. Landis+ Gyr Ltd. (2017) 86 taxmann.com 109 (Kolkata Tribunal) in favour of segregation of the transactions, which was rejected by the Tribunal on account of difference of facts, being incorrect cost allocation in assessee's case. Thus, the Tribunal upheld the TPO's order of combining the three international transactions under the overall `Manufacturing activity' for benchmarking.

The Tribunal, however, observed that the TPO was incorrect in computing the Transfer Pricing adjustments on entity level and directed the TPO to restrict the Transfer Pricing adjustments to manufacturing activity only by relying upon various rulings.

c) *Payment of global software charges* – The TPO determined Nil ALP for payment for global software charges applying benefit test and holding that no independent party would pay for such services. Since similar arose for earlier years, the matter was remanded back to AO/ TPO to decide the same on the basis of directions given by the Tribunal in its earlier years' orders.

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Rendering of inter-connected services under a unified agreement even though through separate orders shall constitute service PE

Telenor ASA vs. DCIT [2021] 129 taxmann.com 198 (Delhi-Trib.) dated August 12, 2021

Recently, the Tax Tribunal, Delhi Bench, held that services rendered by the taxpayer, a tax resident of Norway to an Indian customer through individual orders, although under a unified agreement constituted Service PE in terms of Article 5(2)(l) of the tax treaty between India and Norway.

Article 5(2)(l) of the tax treaty provides that an enterprise shall be deemed to have a PE in a contracting State if it furnishes services (including consultancy services), through employees, for activities that continue (for the same or connected project) for a period or periods exceeding 6 months in any 12 months period in that Contracting State.

On facts, the taxpayer, Telenor ASA, a tax resident of Norway, entered into Business Service Agreement (BSA) with Unitech Wireless (Tamil Nadu) India P. Ltd. (Unitech) in relation to the Global System for Mobile Communication (GSM) role out project. Such

agreement envisaged activities such as preparation, execution and negotiation of GSM awards, IT outsourcing contracts, strategy and product development, IT/IS activities, recruiting and training personnel, security support, etc. As per the BSA, the taxpayer provided services under independent Service Order Forms (SOFs) to Unitech.

The taxpayer considered the receipts from BSA as "fee for technical services" (FTS) and offered the same to tax @10% on gross basis in terms of Article 13 of the tax treaty. During the course of assessment proceedings, the taxpayer contended that the duration of stay of its employees in India for any SOF did not exceed the threshold of six months. However, the Assessing Officer held that the taxpayer had Service PE in India in terms of Article 5(2)(l) of the tax treaty based on the following reasoning:

- services under different SOFs were provided for the same project and the SOFs were integral part of and bound by the BSA.
- the billing scheme showed consolidated invoicing irrespective of the SOFs.
- the employees stayed in India for period exceeding the threshold of six months aggregating stay under all SOFs.

In view of the aforesaid, the Assessing Officer concluded that fees received from Unitech were effectively connected to the PE of taxpayer in India and were taxable as Business Profits under Article 7 of the tax treaty.

Before the Tax Tribunal, the taxpayer contended as under:

- The words "same" or "connected projects" should be interpreted from the perspective of the service provider as clarified in the OECD Commentary on Model Tax Convention on Income and on Capital. As such, merely due to the fact that the customer was the same for all the SOFs, it could not lead to the conclusion that such separate SOFs should be treated as single consolidated project.
- The services specified in the BSA were independent of each other and were merely governed by the terms and conditions prescribed in the BSA. Moreover, each invoice was supported by back-up working and cost details evidencing the distinct nature of SOFs.
- As per the BSA, the taxpayer provided services agreed from time to time under independent SOFs to various group entities of UNINOR group, including Unitech. Various entities have been commonly referred to as UNINOR in the BSA and as such, UNINOR was not a single customer.
- Each requisition by way of issuance of separate SOF had no commercial or geographical coherence with the other SOF issued by UNINOR and therefore, the period of stay of taxpayer's employees under different and separate SOFs could not be aggregated to determine the period of stay for the purposes of Article 5(2)(l) of the treaty.

During the course of the proceedings, the tax authorities highlighted that the language used in Article 5(2)(l) is 'connected projects' and not 'connected services'. As such, the similarity of services is immaterial, while same or connected projects ought to be aggregated to check the total duration of activities. The tax authorities contended that all SOFs were working for the same project and one SOF was the feeder for other SOF.

The Tribunal held that the BSA was a single unified agreement and no single clause was giving it a shape of multiple agreements. The Tribunal found that the activities of the taxpayer with regard to the recipient for services could be said to be inter-connected, inter laced and sequential technical services.

The Tribunal also observed that the activities of the taxpayer started with preparation, execution and negotiation of the GSM to devising the strategy development, preparation of IT solutions architect, benchmarking the same, recruiting the manpower for the purpose of implementation and training them for various activities in relation to GSM role out to customers. All these activities were different facet of one seamless function. There was a clear commercial coherence between activities.

The Tribunal further held that only two entities were involved, UNINOR and the taxpayer. The consolidated invoices raised irrespective of the SOFs led to the conclusion that this was one single contract. In view of the above, the Tribunal, thus, concluded that the taxpayer had Service PE in India.

As regards the question of income attributable to the PE in India, the Tribunal agreed that as all activities under the BSA were not carried out in India, the entire revenue could not be attributed to the PE in India. Accordingly, the issue of determination of profits attributable to the PE was remanded back to the Assessing Officer.

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Domestic Taxation

Conversion of outstanding interest into Debentures is an allowable expense under Section 43B

M.M. Aqua Technologies Ltd. v. CIT (129 taxmann.com 145) (SC)

Recently, the Hon'ble Supreme Court of India has held that payment of accrued interest by issue of debentures was an allowable deduction under Section 43B (enacted with effect from April 01, 1989) of the Income-tax Act, 1961 (Act).

Relevant Provisions of the Income tax law

As per provisions of Section 43B(d) of the Act, an interest payable on loan or borrowing from a public financial institution, state financial corporation or state industrial investment corporation as per the terms and conditions governing such loan or borrowing can be claimed as a deduction on actual payment basis. Thus, a deduction of interest payable on loan or borrowing from certain prescribed institutions can only be claimed in the financial year in which such interest is actually paid by the taxpayer to the prescribed institutions.

Furthermore, Finance Act, 2006 inserted Explanation 3C in Section 43B of the Act which had retrospective effect from April 01, 1989, by virtue of the wording employed therein, to provide that accrued interest payable on loans or borrowings shall not be considered paid if it is not actually paid and if converted into to fresh loan or borrowing shall not be considered as actual payment. .

Facts of the Case

The Appellant filed its income tax return for Assessment Year 1996-97 declaring a loss of INR 10,318,572 and claimed a deduction of INR 28,471,384 under Section 43B of the Act. The said deduction under Section 43B of the Act pertained to accrued interest payable to a financial institution for repayment, in lieu of which the Appellant, had issued debentures. The Assessing Officer disallowed the claim of INR 28,471,384 of the Appellant on the premise that issuance of debentures in lieu of outstanding interest was not as per terms and conditions of the original loan agreement and thus, interest liability could not be considered discharged under Section

43B of the Act. However, the Commissioner (Appeals) and Income Tax Appellate Tribunal allowed the claim on the reasoning that acceptance of debentures by financial institution towards discharge of outstanding interest would be tantamount to actual payment of interest under Section 43B of the Act.

On appeal by Revenue before the High Court of Delhi, the High Court allowed the Revenue's appeal on the rationale that insertion of Explanation 3C in Section 43B with retrospective effect from April 01, 1989 negated the Appellant's contention that conversion of outstanding interest into a "fresh loan" is "actual payment" of interest under Section 43B of the Act.

Decision of the Apex Court

The Apex Court held that the High Court's decision was not tenable as the High Court had considered that the Appellant had converted outstanding interest liability into a loan. Rather, the Apex Court noted that the Appellant had issued debentures towards extinguishment of its actual interest liability instead of a loan.

Further, it was held that interest was "actually paid" by the Appellant upon issue of debentures as the financial institution to whom the debentures were issued had recognised the receipt of debentures as 'Business Income' in its books during the AY under consideration. Thus, conversion of outstanding interest liability into debentures would be regarded as an extinguishment of interest liability and therefore, will be treated as actually paid for the purpose of Section 43B of the Act.

The Court further held that Explanation 3C to Section 43B was a clarificatory provision which was introduced to target taxpayers who did not pay outstanding interest on their borrowings but rather converted it to fresh loan or borrowings and claimed a deduction of the converted interest portion under Section 43B of the Act.

The Court clarified that in the instant case the Appellant had merely issued debentures against accrued interest payable under a rehabilitation plan and there was no misuse of provision of Section 43B of the Act. While interpreting provisions of Explanation 3C, the Court referred to three well established canons of interpretation in interpreting the Explanation 3C, in favour of the Appellant as under:

1. Explanation 3C to Section 43B was introduced vide Finance Act, 2006 for plugging loophole in Section 43B where taxpayers were not paying outstanding interest but rather converting the same to fresh loans or borrowings. The said provision does not intend to target bona fide transactions of actual interest payment.

2. Explanation 3C to Section 43B was applicable retrospectively and the Court held that a "removal of doubts' (i.e., clarificatory) provision cannot be presumed to be retrospective if it alters or changes the law as it earlier stood. The Court held that where a clarificatory explanation changes the law, it cannot be presumed to be retrospectively applicable and has prospective applicability. In this case, the Court found that the said Explanation did not purport to add a new condition retrospectively.

3. Relying on certain earlier judgments, the Apex Court came to the conclusion that an ambiguity in language of Explanation 3C to Section 43B ought to be resolved in favour of the taxpayer

As such, the Apex Court held that where debentures are issued in-lieu of an outstanding interest liability, the amount of interest liability discharged shall be considered as a deduction on "actual payment" basis under section 43B of the Act read with Explanation 3C.

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CORPORATE AND ALLIED LAW

Corporate Law

Limited Liability Partnership (Amendment) Act, 2021

The Ministry of Corporate Affairs [MCA], vide notification dated August 13, 2021, has notified Limited Liability Partnership (Amendment) Act, 2021 [hereinafter referred to as "the Amendment Act"], in order to amend Limited Liability Partnership Act 2008, [hereinafter referred to as "the Act"].

The key highlights of the Amendment Act are as under:

1. **Small LLP:** The Amendment Act provides for formation of a small LLP in line with the concept of "small company" under the Companies Act, 2013 where:

    - the contribution from partners is up to Rs 25 lakh (may be increased up to Rs 5 crores),

    - turnover for the preceding financial year is up to Rs 40 lakh (may be increased up to Rs 50 crores)

    The Central Government may also notify certain LLPs as start-up LLPs (as recognised through notifications)
    Such Small LLPs would be subject to lesser compliances, lesser fee or additional fee and lesser penalties in the event of default.

2. **Standards of accounting:** Under the Amendment Act, a new section 34A has been inserted to empower the Central Government to prescribe the "Accounting Standards" or "Auditing Standards" for a class or classes of limited liability partnerships, in consultation with the National Financial Reporting Authority.

3. **Certain offences decriminalised:** The Act specifies the manner of operations of LLPs, and provides that violating these requirements will be punishable with a fine (ranging between two thousand rupees and five lakh rupees). These requirements include: (i) changes in partners of the LLP, (ii) change of registered office, (iii) filing of statement of account and solvency, and annual return, and (iv) arrangement between an LLP and its creditors or partners, and reconstruction or amalgamation of an LLP. The Amendment Act decriminalises these provisions in order to convert the nature of punishments from fines to monetary penalties.

4. **Punishment for fraud:** Under the Act, if an LLP or its partners carry out an activity to defraud their creditors, or for any other fraudulent purpose, every person party to it knowingly is punishable with imprisonment of up to two years and a fine between Rs 50,000 and five lakh rupees. The Amendment Act has increased the maximum term of imprisonment from two years to five years.

5. The Amendment Act has also amended existing Section 69 of the Act with a view to reduce the additional fee of Rs. 100 per day which is presently applicable for the delayed filing of forms.

**It may be noted that the provisions of the Amendment Act have not come into force as of now, and the provisions shall be effective, from such date, as may be notified by the Central Government, by way of issue of notification(s).*

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Miscellaneous

Important changes brought about in the insurance business by The General Insurance Business (Nationalisation) Amendment Act, 2021

1. The General Insurance Business (Nationalisation) Act, 1972 (“the Act”) was enacted to provide for acquisition and transfer of shares of Indian insurance companies and of undertaking of other insurers in order to serve better the need of the economy. Accordingly, suitable provisions were made therein for the regulation and control of such business and for matters connected therewith.

2. In the year 2002, the above Act was amended to provide for transfer of shares of the Indian insurance companies and for shareholding of the Central Government in the General Insurance Corporation of India and other insurance companies, to be not less than 51% of each entity.

3. Against the above back ground, in order to provide for greater private participation in the public sector insurance companies and to enhance the insurance business and better securing the interests of the policy holders, the Central Government has considered it necessary to amend certain provisions of the above Act.

4. Accordingly, The General Insurance Business (Nationalisation) Amendment Act, 2021 (the Amendment Act) has been passed by the Indian Parliament and has received the assent of the President of India on August 18, 2021. However, the effective date of this Amendment Act has not yet been notified.

5. The salient features of the Amendment Act are as under:

   5.1 The Amendment Act has deleted the proviso to Section 10B of the Act for removing the requirement that the Central Government would be holding not less than 51% of the equity capital in the following insurance companies:

   a) The National Insurance Company Limited;
   b) The New India Assurance Company Limited;
   c) The Oriental Insurance Company Limited; and
   d) The United Indian Insurance Company Limited.

6. The important provision in the Amendment Act is the introduction of a new Section i.e. Section 24B to provide that the provisions of the Act shall cease to apply in respect of the four insurance companies mentioned above, on or from the date of the Central Government ceasing to have control over them.

Note -1:

“Control” for the purpose has been defined to mean the right of the Central

Government in relation to the above four insurance companies:

(a) to appoint the majority of its directors; or
(b) to have power over its management or policy decisions.

Note-2:

It is to be noted that necessary action on the part of the Central Government to relinquish the control in the above four insurance companies will be announced later.

7. The Amendment Act has also inserted a new Section i.e. Section 31A to provide for liability of a Director of the said four insurance companies who is not a whole-time Director, in respect of such acts of omission or commission which has been committed with or without his knowledge.

8. **General**

In addition to the major amendments as referred to above, the Amendment Act contains certain other minor provisions which are of general, drafting nature.

THE ABOVE AMENDMENT ACT PROVISIONS ARE BROUGHT TO THE NOTICE OF ALL CONCERNED FOR INFORMATION AND NECESSARY GUIDANCE IN DUE COURSE.

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Important dates to remember

The Central Board of Direct Taxes (CBDT) has launched the new income tax e-filing portal recently with view to provide a taxpayer-friendly platform to the taxpayers and other stakeholders. However, since the initial launch on June 07, 2021, taxpayers are facing numerous technical glitches while accessing the new portal. As such, it has become difficult for taxpayers to adhere to the prescribed due dates.

With a view to mitigate the difficulty being faced by the stakeholders, CBDT had issued a Circular no. 15 dated August 03, 2021, whereby the timelines for filing certain Forms prescribed under the Income-tax Rules, 1962 ('Rules') were extended.

Considering the continued hardship being faced by the taxpayers till date, CBDT has now issued Circular no. 16 dated August 29, 2021, further extending the due dates for certain compliance.

The extensions pertaining to important compliances have been summarised as under:

Compliance Event	Earlier Timeline as per the Income-tax Act/ extended from time to time	Recently extended Timeline vide Circular dated August 29, 2021
Filing an application for registration/ intimation/ approval under Section 10(23C), Section 12A, Section 35(1)(ii), Section 35(1)(iia), Section 35(1)(iii) and Section 80G of the Income-tax Act (where Form 10A is applicable)	August 31, 2021	**March 31, 2022**
Filing an application for registration/ intimation/ approval under Section 10(23C), Section 12A and Section 80G of the Income-tax Act (where Form 10AB is applicable)	February 28, 2022	**March 31, 2022**
Filing Equalization Levy Statement in Form 1 for Financial Year 2020-21	August 31, 2021	**December 31, 2021**
Furnishing a quarterly statement (in respect of remittances made) in Form 15CC by an authorised dealer for the quarter ending on June 30, 2021	August 31, 2021	**November 30, 2021**
Furnishing a quarterly statement (in respect of remittances made) in Form 15CC by an	October 15, 2021	**December 31, 2021**

authorised dealer for the quarter ending on September 30, 2021		
Uploading the declarations in Form 15G/ Form 15H from recipients for the quarter ending on June 30, 2021	August 31, 2021	**November 30, 2021**
Uploading the declarations in Form 15G/ Form 15H from recipients for the quarter ending on September 30, 2021	October 15, 2021	**December 31, 2021**
Filing of an intimation in Form 3CEAC by a resident constituent entity of an International Group, for the purpose of Section 286 of the Income-tax Act	November 30, 2021	**December 31, 2021**
Furnishing a report in Form 3CEAD by parent entity or an alternate reporting entity or a resident constituent entity of an International Group, for the purpose of Section 286 of the Income-tax Act	November 30, 2021	**December 31, 2021**
Filing an intimation in Form 3CEAE on behalf of an International Group, for the purpose of Section 286 of the Income-tax Act	November 30, 2021	**December 31, 2021**

Further, vide Notification no. 94/2021 dated August 31, 2021, the Income-tax department has extended the last date for making payment (without any additional charge) under Direct Tax Vivad se Vishwas Act, 2020 from August 31, 2021 to September 30, 2021.

Such extension has been made owing to the problems being faced in issuing and amending Form no. 3, which is a prerequisite for making payment by a declarant.

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