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A Monthly Journal of
The Chamber of Tax Consultants

THE CHAMBER'S JOURNAL

February - 2014 | Vol. II | No. 5

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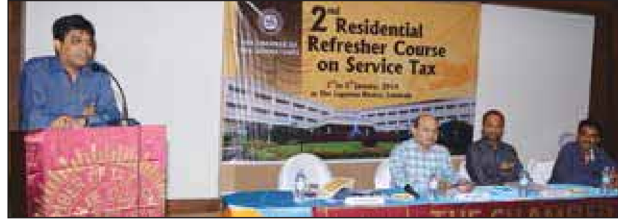
INDIRECT TAXES COMMITTEE

2nd Residential Refresher Course on Service Tax held on 3rd January to 5th January, 2014 at The Lagoona Resort, Lonavala.

CA Yatin Desai, President inaugurating conference by lighting the lamp. Seen from L to R : CA Parimal Parikh, Past President, CA Ashit Shah, Chairman, Shri P. K. Sahu, Faculty, CA Pranav Kapadia, Vice Chairman, CA Rajiv Luthia, Member.



CA Ashit Shah, Chairman welcoming the delegates at 2nd RRC on Service Tax. Seen from L to R: Shri P. K. Sahu, Faculty, CA Yatin Desai, President, CA Pranav Kapadia, Vice Chairman.

Faculties

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Shri V. Raghuraman, Advocate

CA Parind A. Mehta

Shri V. Sridharan, Sr. Advocate

2nd RRC on Service Tax – Group Photo

INFORMATION TECHNOLOGY COMMITTEE

Info Tech Update Series Workshop held on 23rd January, 2014 on the subject "Smart apps for Tax Professionals (How to get the most out of your smart phone)" at Babubhai Chinai Committee, IMC.

CA Sanjay Chheda addressing the members. Seen from L to R : Shri Subhash Shetty, Past President, CA Yatin Desai, President, CA Samir Kapadia, Faculty and Shri Kishor Vanjara, Past President.

RRC & PR COMMITTEE AND MEMBERSHIP & EOP COMMITTEE

2nd Chamber Premier League, 2014 (CPL) held on 18th January, 2014 at Oval Maidan.

Winning Team (CPL – 2014) – Past President – XI

Runner-up Team (CPL – 2014) – Imm. Past President – XI

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Editorial

The month of February has always been very special in the busy schedule of all the members of the Chamber as it is the month of RRC. I am sure everyone is waiting for it to unfold as it would mean lots of interactions in a relaxed environment, in the lap of nature.

The current session of Parliament would draw the curtains over the 15th Lok Sabha and we are heading towards general elections – exciting times indeed!

At such a crucial juncture, a look back at the times sends shivers down the spines of all of us – Indian Democracy is standing at the crossroads and is going through a churn – a churn which has brought to the fore – corruption, inefficiency, apathy, ineptitude, opportunism etc. (the list of adjectives would be long winding) that have left the common man perplexed. The political class as a whole has lost the trust of the common man. However, being an eternal optimist that I am, I would rather see the light at the end of the tunnel rather than the darkness that has surrounded us – the light shed by the fact that despite the exposure of the rot, the masses of India have an unflinching faith in Democracy and its institutions and also in the spirit of the constitution. This was amply visible in the wide-spread disapproval of the 'illegal' methods adopted by a State Government which has been brought into power for being 'different' and 'clean'.

With this faith, I wish the next general elections would set the agenda of development and empowerment of all classes of the populace. I wish the political class of the country hears the clarion call that public cannot be fooled into loyalty by mere gimmicks and that they need to rework their goals and methods.

This edition of Chambers' Journal has a Special Story on International Taxation. My sincere thanks to all the authors who contributed to this edition. Special thanks to Shri Paresh Shah for his efforts.

K. GOPAL
Editor

From the President

Dear Members,

February is the most awaited month in the Calendar of the Chamber as in February we have our flagship event i.e. Residential Refresher Course (RRC). This year it happens to be 37th RRC and coincidentally, I am the 37th President. RRC, for the first time, will be held at Pondicherry, which is on the Eastern Coast of India. Overwhelming response to the venue will open gates for the future RRCs at farther places. The Chairman of the RRC committee and his team members along with the Advisor Mr. Kishor Vanjara have put in utmost efforts in planning to make the RRC educative and entertaining. The Chamber has a practice of introducing atleast one paper writer presenting his paper for the first time. The legacy continues. This year, we have two papers which will be presented by the paper writers for the first time for the Chamber. Pondicherry is known for Aurobindo Ashram. The place where people come from around the world for practicing Yoga. And keeping that in mind, the theme of the RRC is rightly kept, 'Meditate…Introspect…Reflect!!!' By the time you receive copy of this issue, the RRC would have been over. I am sure the RRC will turn out to be educative, entertaining and memorable.

The Chamber played 2nd Cricket match, Chamber's Premier League 2014 on 18th January, 2014. The matches were played in the festive mood and in the true spirit of the game. However, this year too, it was marred by injuries by way of fractures to two members. The events such as this, reminds us for keeping ourselves fit and healthy.

The Chamber's Journal is the mouthpiece of the Chamber. The Committee tries to lift the quality of the Journal on an ongoing basis. Periodically, the Committee invites contributors for a meeting, called Marathon Meeting, for their suggestions to improve the Journal. Recently, a meeting was held which was well attended and many suggestions were received. The Committee will collate the same and see how best they can be implemented.

The Chamber is also envisaging changes in its 'Rules and Regulations'. A Sub-Group had been formed and draft of the

amendments to rules have been completed . The same was put before the meeting of Past Presidents Advisory Board for their comments. The meeting was very well attended by the Past Presidents who provided their valuable suggestions. It is heartening to know that all the Past Presidents came prepared and provided their valuable suggestions in the meeting or sent their suggestions in advance for the discussions. I salute all the Past Presidents for their dedication, commitment and love for the Chamber.

After an era of virtual or plastic money, virtual currencies like Bitcoins and others are in news. There are more than 60 virtual currencies. Bitcoin is one of the largest and account for USD 9 bn. out of total estimated size of USD 13 bn. It is said that these currencies are mainly used by illegal drug cartels and for money laundering activities due to anonymity and having no trail. Regulatory restrictions in India and other countries have little impact on use of Bitcoins and other virtual currencies.

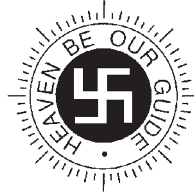
It is a proud moment for us Indians that Microsoft has named Indian born Satya Nadella, as its new CEO. Nadella, only 46, will became only the third leader in the software giant's 38-year history, after Gates and Ballmer.

In the time when polls are staring in the eyes, politicians and government have suddenly started clearing proposals and projects and giving positive outlook. Some of the news items are; Fiscal deficit likely to come down to 4.7% in 2013-14: report, Current account deficit likely to decline to $ 45 billion in F.Y. 2014: Finance Ministry, 5.6% growth likely next year, stable government is vital: Citigroup, India Rs. 105 lakh-crore economy; per capita income rises to Rs. 74,920. So on and so forth. Has the economy really turnaround dramatically or as usual a poll gimmicks?

Let us come back to the Chamber. The coming months are full of activities. Many intensive courses and seminars are planned. I request members to take benefit of the same.

The subject of this month’s Journal is International Taxation. The design was provided by Shri Paresh P. Shah. I appreciate efforts of Shri Paresh P. Shah for providing design and Ms. Toral Shah, the convenor for co-ordinating the same.

Yatin Desai
President



The Chamber of Tax Consultants

Vision Statement

The Chamber of Tax Consultants (The Chamber) shall be a powerhouse of knowledge in the field of fiscal laws in the global economy.

The Chamber shall contribute to the development of law and the profession through research, analysis and dissemination of knowledge.

The Chamber shall be a voice which is heard and recognised by all Government and Regulatory agencies through effective representations.

The Chamber shall be pre–eminent in laying down and upholding, among the professionals, the tradition of excellence in service, principled conduct and social responsibility.

V. H. Patil, *Advocate*

An Introduction to – Ved and Vedanta

BHAKTI – YOGA

After dealing with Karma Yoga, the yoga of realisation through doing right actions, let us now turn to Bhakti Yoga.

Bhakti Yoga is a yoga of realising God through constant love for God.

Bhakti may be defined as a constant love towards God. Bhakti is defined by Maharshi Narada, in his Bhakti sutras. 'Bhakti is an intense love God, when a man gets it, he loves all, hates none, he becomes satisfied forever. This love cannot be reduced to any earthly benefit. "Bhakti is greater than karma, greater than jnana yoga, because these are intended to an object in view, while Bhakti is its own end".

However there is really no much difference between knowledge (jnana) and Bhakti as some people think. At the end they converge and meet at the same point of realisation of God.

In a way Bhakti Yoga, among all the yogas, is the simplest of realisation, because love is very common and as such it is rather easy to turn towards God.

However its great disadvantage is its way of its practice may de-generate in its lower form, many times degenerates into hideous fanatism and the followers of one religion may think that theirs is the only religion which leads to realisation and others will not lead to realisation and they accordingly hate other religions, and persecute those who are not following their religion, when really all these religions are different ways of realisation.

Now before dealing with Bhakti Yoga as per Bhagavad Gita, let us take the resume of Chapter 1 to 11 before coming to chapter 12.

Chapters 1 to 5 deal with the philosophy of life (jnana) and the ways of implementing the philosophy of life and the ways of realisation of philosophy by way of Jnana yoga and karma yoga.

These Chapters delt with three basic principles underlying the philosophy of life (i) Paramatma is all pervasive, all pervading both inside and outside universe, (ii) Atma is Anadi and Ananta, it is always there, it was there, it is there, and it will be there, for eternity, (iii) the object and purpose of life and living is to realise one's self and to merge with Paramatma.

SAGUNA AND NIRGUNA BHAKTI

In fact, the principle of Bhakti has been introduced in the sixth chapter itself. The first five chapters deal with the science of life. They deal with karma (in the form of performance of swadharma), vikarma (the mental sadhan, the inner complementary process which helps that karma) and the final state of a karma that results from their confluence and burns to ashes all the karma. With this, the exposition of the science of life is complete. In one sense, it is the principle of Bhakti that has been discussed thereafter from the sixth chapter to

the eleventh. The sixth chapter tells us how to have one-pointedness of mind and discusses the means therefore and the need for it. The eleventh chapter presents the complete and holistic vision Let us now see how we have made the long journey from one-pointedness to this vision.

Beginning was made with one-pointedness of mind. Once this is achieved, one becomes capable of pursuing any study. One-pointedness of mind can be utilized for the study of any subject with good results. But such a study is not the highest goal of the concentration of mind. The study of mathematics, for example, does not fully test the concentration of mind. Concentration of mind can surely help in achieving proficiency in mathematics or any other branch of knowledge, but this is not its true test. Hence it was recommended in the seventh chapter that we should concentrate our mind on the feet of the Lord. The eighth chapter exhorts us to try continuously, till the moment of death, to be at the feet of the Lord with all the sense organs devoted to Him and the whole being dedicated to His service. All our sense organs must be trained to serve this one purpose (all the sense have become used to devotion; there is nothing else in the mind) – This is what should happen. All the senses should be madly in love of the Lord. Those around us may be wailing or singing hymns, they may be absorbed in weaving webs of desires and passions, or one may be in the company of saintly persons; whatever may be the condition, the senses should be trained by constant practice in such a way that the thought of the Lord would be in mind at the moment of death. This lesson of constancy has been given in the eighth chapter. To sum up, there is teaching of concentration of mind in the sixth chapter, that of *prapatti* or concentration directed to the Lord in the seventh, of the yoga of ceaseless striving in the Eighth and that of devotion to the Lord in the ninth chapter. The tenth chapter tells us how to proceed step-by-step to grasp gradually that the Lord is pervading the entire creation right from an ant to the creation of all beings. The eleventh chapter presents the complete and holistic vision. I call this vision of the cosmic form the yoga of totality. This vision essentially means realising that the whole world is contained in a grain of sand. This is the complete and total vision. The element of Bhakti has thus been examined from different angles from the sixth to the eleventh chapters.

In the last two shlokas of chapter eleven. The Lord, after showing his Sakara form and Nirakara form tells Arjuna, that a Bhakta can reach Him following either of these two paths.

Chapter twelve can be divided into three shlokas: (i) to 5 worships of form and formless God sakar and Nirakar, (ii) Progressive ways to reach God – shlokas 6 to 12 (iii) Thirty five Gunas of Bhakta – shlokas 13 to 20.

I. Form and formless worship

Arjuna expresses his doubt to Krsna regarding the mode of worship. Does one worship God with a form? Or the unmanifest Reality without a form? Which of the two is more suitable for approaching God? Better designed for a seeker's spiritual evolution?

Krsna considers Arjuna to be more devotional. He, therefore, declares worshipping Him as the better approach. But, He follows up His declaration by affirming that worshippers of the Unmanifest also reach God. The devotional need a form, an idol for worship. They lack the capacity to focus their concentration on the unmanifest Ideal without the help of an idol. Whereas, the intellectual, the introvert can concentrate on the all-pervading formless Reality. Either way, a seeker finally uses single-pointed concentration and mediation to gain Enlightenment.

II. Progressive ways to reach God

A spiritual seeker must reach an advanced state of concentration before he can actually mediate and attain Godhood, Self-realisation. In deep mediation the mind is set on the Self with the intellect supporting it. A seeker maintains this state of single-pointedness before merging with the Self. This being the most advanced and ultimate spiritual practice few can directly relate to it. To those less evolved, Krsna advises self-purification

through constant practice of spiritual disciplines. The practice of these helps you withdraw the mind from the world and concentrate upon the Self. If you cannot practice even spiritual discipline you then surrender all your actions to the Lord. Perform actions for His sake. Not merely to satisfy your personal desires. If this also is not possible, keep the goal of Realisation in mind while acting in the world. You may satisfy your desires but renounce the anxiety for the fruits of your actions.

The topic's last verse provides four facets of spiritual practices. Any spiritual practice must be backed by knowledge. A seeker must practise a discipline with full understanding of its significance and purpose. It then leads him to concentrate and meditate upon the supreme Goal. He must then mediate without an anxiety for the result. In this spirit of renunciation the meditator attains the absolute State of peace and bliss.

FOUR TYPES OF BHAKTAS

It is Bhakti with knowledge which the Gita demands from the disciple and it regards all other forms of devotion as good in themselves but still inferior; they may do well by the way, but they are not the thing at which it aims in the soul's culmination. Among those who have put away the sin of the rajasic egoism and are moving towards the Divine, the Gita distinguishes between four kinds of Bhaktas. There are those who turn to him as a refuge from sorrow and suffering in the world, *arta*. There are those who seek him as the giver of good in the world, *artharthi*. There are those who come to him in the desire for knowledge, *jinasu*. And lastly there are those who adore him with knowledge, jnani. All are approved by the Gita, but only on the last does it lay the seal of its complete sanction. All these movements without exception are high and good, *udarah sarva evaite*, but the Bhakti with knowledge excels them all, *visisyate*. We may say that these forms are successively the Bhakti of the vital emotional and affective nature, that of the practical and dynamic nature, that of the reasoning intellectual nature, and that of the highest intuitive being which takes up all the rest of the nature into unity with the Divine. Practically, however, the others may be regarded as preparatory movements. For the Gita itself here says that it is only at the end of many existences that one can, after possession of the integral knowledge and after working that out in oneself through many lives, attain at the long last to the Transcendent. For the knowledge of the Divine as all things that are difficult to attain and rare on earth is the great soul, mahatma, who is capable of fully so seeing him and of entering into him with his whole being, in every way of his nature, by the wide power of this all-embracing knowledge, *sarvavit sarvabhavena*.

Still the Supreme Godhead does not at all reject these devotees because of their imperfect vision. For the Divine in his Supreme transcendent being, unborn, imminuable and superior to all these partial manifestations, cannot be easily known to any living creature. He is self-enveloped in this immense cloak of Maya, that Maya of his Yoga, by which he is one with the world and yet beyond it, imminent but hidden, seated in all hearts but revealed to any and every being. Man in Nature thinks that these manifestations in Nature are all the Divine, when they are only his works and his powers and his veils. He knows all past and all present and future existences, but him none yet knoweth. If then after thus bewildering them with his workings in Nature, he were not to meet them in these at all, there would be no divine hope for man or for any soul in Maya. Therefore according to their nature, as they approach him, he accepts their Bhakti and answers to it with the reply of divine love and compassion. These forms are after all a certain kind of manifestation through which the imperfect human intelligence can touch him, these desires are first means by which our souls turn towards him; nor is any devotion worthless or ineffective, whatever its limitations. It has the one grand necessity, faith, "whatever form of Me any devotee with faith desires to worship, I make that faith of his firm and undeviating."

By the force of that faith in his cult and worship he gets his desire and the spiritual realisation for

which he is at the moment fitted. By seeking all his good from the Divine, he shall come in the end to seek in the Divine all his good. By depending for his joys on the Divine, he shall learn to fix in the Divine all his joy. By knowing the Divine in his forms and qualities, he shall come to know him as the All and the Transcendent who is the source of all things.

ABSOLUTE SELF-SURRENDER

This absolute self-giving, this one-minded surrender is the devotion which the Gita makes the crown of its synthesis. All action and effort are by this devotion turned into an offering to the supreme and universal Godhead. "Whatever thou doest, whatever thou enjoyest, whatever thou sacrificest, whatever thou givest, whatever energy of Tapasya, of the soul's will or effort thou puttest forth, make it an offering unto Me."

Here the least, the slightest circumstance of life, the most insignificant gift out of oneself or what one has, the smallest action assumes a divine significance and it becomes an acceptable offering to the Godhead who makes it a means for his possession of the soul and life of the God-lover. The distinctions made by desire and ego then disappear. As there is no straining after the good result of one's action, no shunning of unhappy result, but all action and result are given up to the Supreme to whom all work and fruit in the world belong forever, there is no further bondage. For by an absolute self-giving all egoistic desire disappears from the heart and there is a perfect union between the Divine and the individual soul through an inner renunciation of its separate living. All will, all action, all result become that of the Godhead, work divinely through the purified and illumined nature and no longer belong to the limited personal ego. The finite nature thus surrendered becomes a free channel of the Infinite; the soul in its spiritual being, uplifted out of the ignorance and the limitation, returns to its oneness with the Eternal. The Divine Eternal is the inhabitant in all existences; he is equal in all and the equal friend, father, mother, creator, lover, supporter of all creatures. He is the enemy of none and he is the partial lover of none; none has he cast out, none has he eternally condemned, none has he favoured by any despotism of arbitrary caprice; all at last equally come to him through their circling in the ignorance. But it is only this perfect adoration that can make this in dwelling of God in man and man in God a conscious thing and an engrossing and perfect union. Love of the Highest and a total self-surrender are the straight and swift way to this divine oneness.

HUMAN REPRESENTATION OF THE DIVINE IDEAL OF LOVE

The teachers of the doctrine of Bhakti have tried to represent this inexpressible divine love in terms of human love and its varied forms. Any expression of the Infinite in terms of the finite has its imperfection. But that is unavoidable, it being the only means possible. "The whole universe is to us a writing of the Infinite in the language of the finite." These forms of love are graded as follows according to the intensity of the personal affection involved.

1. **Santa:** Devotion that has risen above ceremonialism and is constant and philosophically oriented but is without that madness of intensely active love, is called Santa. Such Bhakti is calm, peaceful and gentle.

2. **Servantship:** This comes when the devotee develops the feeling that he is a faithful and eternal servant of God and has attachment to Him appropriate to this relationship.

3. **Sakhya or friendship:** A sense of equality with the Lord, confidence, and a lack of awe in the face of His divine majesties are characteristic of this form of love. Moreover the devotee becomes a playmate of God in His grand cosmic sport. The doctrine of the universe as the Divine lila or sport is as follows: God, the perfect being has no wants, and hence no purpose yet to be achieved can be attributed to His creative activity. So it has to be described as His sport, and the

devotee must feel that he is a participant in this Divine sport. He is to feel that God is his eternal playmate, and His creation a sport. "As soon as you give up the serious idea of reality as the characteristic of the changing incidents of the three minutes of life and know it to be but a stage on which we are playing, helping Him to play, at once misery ceases for you….. He is playing when He is building up the earths and suns and moons; He is playing with the human heart, with animals, with plants. We are his chess-men… and we are consciously or unconsciously helping in His play. And Oh., bliss! We are His playmates."

4. **Vatsalya:** It means loving God as our child. Here the fear-creating majesty of God is completely forgotten. Also reverence obedience and such restraining influences are abandoned. God becomes a little child needing the devotee's love and protection. Such a form of love is possible only in societies that accept the idea of divine Incarnation.

5. Madhura or Conjugal: In devotional philosophy, this is considered the highest and the most intense form of devotion. The love between a man and a woman, which is the most powerful form of human love, is utilised in the cultivation of devotion…"God is the only male and the souls are his wives, and the devotee develops a passionate love for Him in the light of this relationship. All the passionate love of the human heart must go to God. He is the Beloved. Whom else can this heart love?... Who I the universe is more fit to become the husband than He?"

Often devotees cultivating this form of love utilise the language and form of human love in their descriptions of these diverse sentiments. Those who look at these descriptions from a purely physical point of view misunderstand it; for only when the dominance of the physical sense has abated, can this form of love be practiced or understood. "Fools do not understand this; they never will. They look at it only with the physical eye. They do not understand the mad throes of the spiritual love. How can they? `For one kiss of Thy lips, O Beloved! One who has been kissed by Thee, has his thirst for Thee increasing for ever; all his sorrows vanish, and he forgets all things except Thee alone!' Aspire after that kiss of the Beloved, that touch of His lips which makes the Bhakta made, which makes of man a God. To him, who has been blessed by such a kiss, the whole of Nature changes, worlds vanish, suns and moons die out, and the universe itself melts away into that infinite ocean of love. That is the perfection of the madness of love…."

To further intensify the sense of attachment to, and dependence on God, Bhaktas take up the symbolism of the illicit love of a girl for her lover. The highest illustration of this we get in the love of the Gopis for Krishna. "Human language cannot describe how Krishna in the groves of Vrinda was madly loved, how at the sound of his voice the ever-blessed Gopis rushed out to meet him forgetting everything, forgetting the world and its ties, its duties, its joys and its sorrows. Man, O man, you speak of divine love and at the same time are able to attend to all the vanities of the world. Are you sincere? `Where Rama is, there is no room for any desire, where desire is, there is no room for Rama'; these never co-exist, like light and darkness they are never together."

This type of Prema Bhakti, intense love of God, sets at naught all worldly values. To a critic of such intense God-love, Sri Ramakrishna once replied: "My friends, the whole world is a lunatic asylum. Some are made after worldly love, some after name, some after fame, some after money, some after salvation and going to heaven. In this big lunatic asylum, I am also mad I am mad after God. If you are mad after money, I am mad after God. You are mad; so am I. I think my madness is after all the best."

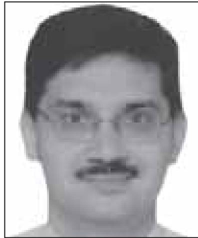
"We all begin as dualists in the religion of love. God is to us a separate Being. Love comes between in the middle, and man begins to approach God and God also comes nearer and nearer to man…. As father, mother, son, friend, master and love…

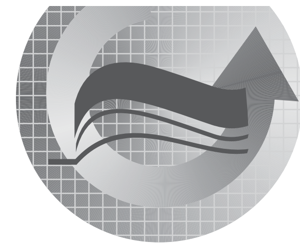
and the last point of progress is reached when the devotee feels that he has become absolutely merged in the object of his worship."

UNIVERSAL LOVE AND HOW IT LEADS TO SELF-SURRENDER

How can we love the Vyashti, the particular, without first loving the Samasthi, the universal? God is the Samashti, the generalized and the abstract universal whole; and the universe that we see is the Vyashti, the particularised thing. To love the whole universe is possible only by way of loving the Samashti – the universal – which is, as it were, the one unity in which are to be found millions and millions of smaller unities. The philosophers of India do not stop at the particulars; they cast a hurried glance at the particulars, and immediately start to find the generalised forms which will include all the particulars. The search after the universal is the one search of Indian philosophy and religion. The Jnani aims at the wholeness of things, at that one absolute and generalised Being, knowing which he knows everything. The Bhakta wishes to realise that one generalised abstract Person, in loving whom he loves the whole universe. The Yogi wishes to have possession of that one generalised form of power, by controlling which he controls this whole universe. The Indian mind, throughout its history, has been directed to this kind of singular search after the universal in everything-in science, in psychology, in love, in philosophy. So the conclusion to which the Bhakta comes is that, if you go on merely loving one person after another, you may go on loving them so for an infinite length of time, without being in the least able to love the world as a whole. When, at last, the central idea is, however, arrived at, that the sum total of the aspirations of all the souls in the universe, whether they be free, or bound, or struggling towards liberation is God, then alone it becomes possible for anyone to put forth universal love, God is the Samasthti, and this visible universe is God differentiated and made manifest. If we love this sum total, we love everything. Loving the world and doing it good will all come easily then; we have to obtain this power only by loving God first; otherwise it is no joke to do good to the world. "Everything is His and He is my Lover; I love Him," says the Bhakta. In this way everything becomes sacred to the Bhakta, because all things are His. All are His children, His body, His manifestation. How then may we hurt anyone? How then may we not love any one? With the love of God will come, as a sure effect, the love of everyone in the universe. The nearer we approach God, the more do we begin to see that all things are in Him. When the soul succeeds in appropriating the bliss of this supreme love, it also begins to see Him in everything. Our heart will thus become an eternal fountain of love. And when we reach even higher states of this love, all the little differences between the things of the world are entirely lost; man is seen no more as man, but only as God; the animal is seen no more as animal, but as God; even the tiger is no more a tiger, but a manifestation of God. Thus, in this intense state of Bhakti, worship is offered to everyone, to every life, and to every being "knowing that Hari, the Lord, is in every being, the wise have thus to manifest unswerving love towards all beings."

As a result of this kind of intense all-absorbing love, comes the feeling of perfect self-surrender, the conviction that nothing that happens is against us, Apratikulya. Then the loving soul is able to say, if pain comes, "Welcome pain." If misery comes, it will say, "Welcome misery, you are also from the Beloved." If a serpent comes, it will say, "Welcome serpent." If death comes, such a Bhakta will welcome it with a smile. "Blessed am I that they all come to me; they are all welcome." The Bhakta in this state of perfect resignation, arising out of intense love to God and to all that are His, ceases to distinguish between pleasure and pain in so far as they affect him. He does not know what it is to complain of pain or misery; and this kind of uncomplaining resignation to the Will of God, who is all love, is indeed a worthier acquisition than all the glory of grand and heroic performances.





CA N. C. Hegde

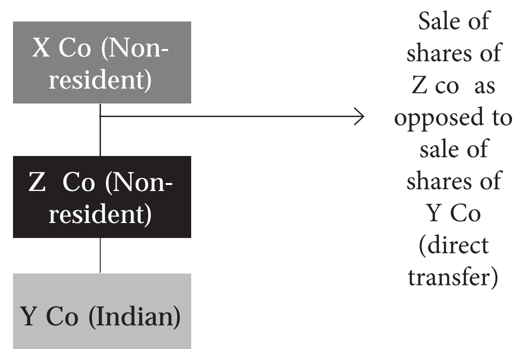
Indirect Transfer and Capital Gains

Indirect transfers

If there has been one major topic of discussion in India that has dominated the tax landscape as far as foreign investors are concerned in the last five years, it would have to be that of taxation of "indirect transfers". Further there has seldom been a subject where views on the subject are as sharply divided as this one. It is therefore important to understand what this entire controversy on indirect transfer is and examine the evolving law on the subject.

After the opening up of the Indian economy in 1991, there has been a significant flow of foreign direct investment into India. Often, these investments are structured in a manner by which an investor creates a holding company in a favourable (no or low tax) jurisdiction with the holding company having a subsidiary or joint venture company in India. Based on subsequent opportunities/developments there may arise a situation when the investor wants to exit from a particular investment in India. In such a situation the foreign investor has two options i.e. either to sell his stake in the Indian company to another investor, or to sell his stake in a holding company to the new investor. In the first case, the transaction involves transfer of shares of the Indian company or a direct transfer. In the second case, the transaction occurs outside India among foreign entities. **It is this latter case that is referred to as indirect transfer.**

Indirect share transfer



Taxability of indirect transfers before the amendment by Finance Act, 2012

In case of sale of shares of an Indian company (the first case mentioned above), the situs of shares is in India and the transfer of shares also takes place in India. Hence, income accrues and arises in India. To avoid uncertainty, through a deeming fiction, income through transfer of any capital asset situated in India is deemed to accrue or arise in India. (section 9(1)(i)).

However a question arises on the taxability when despite the fact that the underlying asset

is in India, a transfer of shares of the holding company takes place between two non-residents. The question which really merits attention is the situs of shares of the foreign company i.e. is it in the foreign jurisdiction where the company is registered or in the place where the underlying assets of the company are situated (i.e. where the main business activities are taking place).

It has been the argument of Revenue in recent years that by transfer of shares of the holding company, it is the business assets located in India that are transferred, albeit indirectly. Hence, the capital gains should be taxable in India. This contention as well as the other plea of looking through the transaction formed part of the arguments of the Revenue as they defended the taxability of indirect transfers before the Supreme Court. in *Vodafone International Holdings B.V. vs. Union of India (341 ITR 1)*

The Supreme Court explained the position of law on the subject and held as under:

Under the general theory of nexus relevant for examining the territorial operation of the legislation, two principles that are generally accepted for imposition of tax are:

(a) Source and

(b) Residence

Section 5 specifies the principle on which tax can be levied. Section 5(1) prescribes "residence" as a primary basis for imposition of tax and makes the global income of the resident liable to tax. Section 5(2) is the source based rule in relation to residents and is confined to income that has been received in India; and income that has accrued or arisen in India or income that is deemed to accrue or arise in India.

In the case of a Non-Resident, income which is received or is deemed to be received in India during the relevant previous year by or on behalf of such person; and any income which accrues or arises or is deemed to accrue or arise to him in India during the relevant previous year is taxable in India.

Section 9 deals with the incomes which are deemed to accrue or arise in India. Section 9 thus extends its provisions to certain incomes which are deemed to accrue or arise in India. Four kinds of income are deemed to accrue or arise in India, viz income from:

(a) a business connection in India;

(b) a property in India;

(c) an establishment or source in India; and

(d) transfer of a capital asset in India.

In a case of an indirect transfer, the relevant clause for examination would be the last sub-clause of section 9(1)(i) which refers to income arising from **"transfer of a capital asset situate in India".** Thus, charge on capital gains arises on transfer of a capital asset situate in India during the previous year. The said sub-clause consists of three elements, namely, **transfer, existence of a capital asset,** and **situation of such asset** in India. All **three elements** should exist in order to make the last sub-clause applicable. Therefore, if such a transfer does not exist in the previous year no charge is attracted. Further, Section 45 enacts that such income shall be deemed to be the income of the previous year in which transfer took place.

Given that the shares of a foreign company could not be considered as "situate" in India, the Revenue contended before the Supreme Court that under Section 9(1)(i) one had to "look through" the transfer of shares of a foreign company holding shares in an Indian company and treat the transfer of shares of the foreign company as equivalent to the transfer of the shares of the Indian company on the premise that Section 9(1)(i) covers direct and indirect transfers of capital assets. However the Supreme Court did not accept the argument on the ground that Section 9(1)(i) could not by a process of interpretation be extended to cover indirect transfers of capital assets/property situate in India. According to the Supreme Court, to do so, would amount to changing the content and

ambit of Section 9(1)(i). Section 9(1)(i) could not be rewritten. The legislature has not used the words indirect transfer in Section 9(1)(i). If the word indirect is read into Section 9(1)(i), it would render the express statutory requirement of the 4th sub-clause in Section 9(1)(i) nugatory. This is because Section 9(1)(i) applies to transfers of a capital asset situate in India. . Similarly, the words underlying asset do not find place in Section 9(1)(i). The Supreme Court observed that, the words directly or indirectly used in Section 9(1)(i) go with the income and not with the transfer of a capital asset (property).

Amendments by the Finance Act, 2012

With a view to get over the decision of the Supreme Court in the case of Vodafone, the Finance Act, 2012 had carried out certain amendments with retrospective effect which have enabled the Revenue to tax capital gains in an offshore transaction. This has sought to be done by inserting Explanations to the terms "property", "transfer", "through" and "capital asset situated in India". These are further discussed as under:

Property" [Explanation 2 to Section 2(14)]

The Supreme Court in Vodafone had held that a *controlling interest is an incident of ownership of shares in a company, something which flows out of the holding of shares. A controlling interest is, therefore, not an identifiable or distinct capital asset independent of the holding of shares. The control of a company resides in the voting power of its shareholders and shares represent an interest of a shareholder which is made up of various rights contained in the contract embedded in the Articles of Association. The right of a shareholder may assume the character of a controlling interest where the extent of the shareholding enables the shareholder to control the management. Shares, and the rights which emanate from them, flow together and cannot be dissected.*

Accordingly, an Explanation to clause (14) of Section 2 which defines the term "capital asset" as a property of any kind has been inserted as under –

'*Explanation.*—For the removal of doubts, it is hereby clarified that "property" includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever'.

Thus an effort has made to provide that the right of management or control or any other rights in a company may be treated as a separate property over and above the shares. This is intended to cover situations where some assets such as right to control or management in a company are being transferred separately from the transfer of shares of the company.

Transfer [Explanation 2 to section 2(47)]

The definition of the term "transfer" in clause (47) of Section 2 has been amended as under –

'*Explanation 2.*—For the removal of doubts, it is hereby clarified that "transfer" includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterised as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India'.

Further it is irrelevant whether such transfer of rights has been characterised as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India. It may be noted that by insertion of the phrase "shall be deemed to have always included", an element of retrospectively is sought to be smuggled into the

scope of transfer and, as its extension, indirect transfer.

"Through" [Explanation 4 to Section 9(1)(i)]

A new Explanation has been inserted as Explanation 4 to Section 9(1)(i) as under:

'*Explanation 4.* — For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".'

In the context of indirect transfer, where an Indian company is to be transferred, and for that reason shares in the holding company are transferred, it would imply that income arising on transfer of shares of the holding company is by reason of transfer of the Indian company, and consequently it should be taxable in India.

"Capital asset situated in India" [Explanation 5 to Section 9(1)(i)]

The Supreme Court had held in the case of Vodafone that under the Indian Companies Act, 1956, the situs of the shares would be where the company is incorporated and where its shares can be transferred. The contention that situs of the shares of an overseas company was situated in the place (India) where the underlying assets stood situated, could not be accepted.

To get over the above observation and to shift the situs in case of an indirect transfer, the meaning of the expression **"asset or capital asset situated in India"** in clause (i) of sub-section (1) of section 9 has been amended by inserting an Explanation as under:

'*Explanation 5.*— For the removal of doubts, it is hereby clarified that an asset or a capital asset being any **share or interest in a company or entity** registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, **directly or indirectly,** its value **substantially** from the assets located in India.' (emphasis added).

Thus, shares of a foreign company (holding company), which holds substantial assets in India, shall be deemed to be situated in India and consequently, any transfer of such shares, even outside India, shall be taxable in India under the domestic law. However, the terms "share or interest in a company or entity", "directly or indirectly", "value" and "substantially" have not been defined and may, therefore, lead to ambiguity.

As may be noted the Finance Act, 2012 has made certain that there is no possible loophole for an indirect transfer which involves a substantial transfer of assets to escape the tax net. However in their anxiety to rope in indirect transfers, the law has unfortunately created a tax exposure for other transactions which were never sought to be so taxed.

Shome Committee's key recommendations on indirect transfers

As a result of the amendments made by the Finance Act 2012 as discussed earlier, there was a huge concern raised by taxpayers and foreign investors. With a view to allay the concerns of all stakeholders, the Government appointed a committee headed by Dr. Shome to look into the entire taxation of indirect transfers. The Shome Committee which was appointed for this purpose has made an in-depth study on the subject including tax provisions in other countries and has submitted a report providing their recommendations on the issue. Some of the key recommendations to alleviate unintended difficulties are highlighted in the following paragraphs.

- The phrase, ***"an asset or"*** seems to be juxtaposed with capital asset to buttress

the concept of capital assets. Since the objective is taxation of capital assets alone, the phrase *"an asset or"* should be omitted.

- The phrase, ***"the share or interest in a company or entity registered or incorporated outside India,"*** should mean and include only such share or interest which results in participation in ownership, capital, control or management. Mere **economic interest** should not be contemplated within the ambit of Explanation 5 to Section 9(1)(i).
- The word ***"Value"*** should refer to ***fair market value of both tangible and intangible assets*** as may be prescribed. The value is to be determined at the time of the last balance sheet date of the foreign company with appropriate adjustments made for significant disposal/acquisition, if any, between the last balance sheet date and the date of transfer.
- The phrase ***"directly or indirectly"*** may be clarified to represent a "look through approach" whereby all intermediaries between the foreign company and assets in India may be ignored.
- The word ***"substantially"*** used in Explanation 5 should be defined as a threshold of 50%.
- The **taxation of capital gains on indirect transfer should be restricted only to capital gains attributable to assets located in India.** Thus capital gains should be taxed on a basis of proportionality between fair market value of the Indian assets and global assets of the foreign company, as proposed in DTC Bill, 2010.
- Exemption may be provided to a **foreign company** which is listed on a recognised stock exchange and whose shares are frequently traded therein.
- **Transfer of shares or interest** in a foreign company or entity **under intra group restructuring** may be exempted from taxation subject to the condition that such transfers are not taxable in the jurisdiction where such company is resident.
- Where capital gains arising to a non-resident on account of transfer of shares or interest in a foreign company or entity are taxable under Section 9(1)(i) of the Act and there is a DTAA with country of residence of the non-resident, then **such capital gains shall not be taxable in India unless** – (i) the DTAA provides a right of taxation of capital gains to India based on its domestic law; or (ii) the DTAA specifically provides right of taxation to India on transfer of shares or interest of a foreign company or entity.
- There should be prospective application of amendments to Section 9 on indirect transfers.

Capital Gains on indirect transfers under the Treaty

Having examined the position of taxation of indirect transfers under the domestic law, it would be worthwhile to examine the position of taxation of indirect transfers under the treaty.

Section 90(2) of Income-tax Act, 1961 provides for a treaty override of the provisions of the domestic law in situations where the treaty provisions are more beneficial. *Section 90(2A) which limits the relief in case of application of GAAR is not presently discussed as this would have effect only after GAAR comes into force from 1st April 2015.*

Attention is also invited to the Finance Minister's speech in Parliament on 10th May, 2012, at the time of announcement of Government amendments as under:

"Hon'ble Members are aware that a provision in the Finance Bill which seeks to retrospectively clarify the provisions of the Income-tax Act relating to capital gains on sale of assets located in India through indirect transfers abroad, has been intensely debated in the country and outside. I would like to confirm that clarificatory amendments do not override the provisions of Double Taxation Avoidance Agreement (DTAA) which India has with 82 countries. It would impact those cases where the transaction has been routed through low tax or no tax countries with whom India does not have a DTAA."

Thus on a reading of the relevant provisions of the law, it is clear that if an indirect transfer is not taxable as per the treaty that India has, it could still escape the tax net.

The DTAAs entered into by India with other countries have different formulations for taxation rights on capital gains. These may be divided, mainly, into four categories –

i. India has right of taxation of all capital gains as per its domestic law (e.g. US and UK);

ii. India has right of taxation of capital gains arising on alienation of shares of an Indian company (in most treaties);

iii. India has right of taxation of capital gains arising on alienation of shares of an Indian company only if the transferee is a resident of India (e.g. Netherlands);

iv. India does not have right of taxation of capital gains arising on transfer of shares of an Indian company (e.g. Mauritius, Singapore, Cyprus).

Having looked at the overall formulation on taxation rights for capital gains, one needs to look at the specific articles of the UN Model Convention which could deal with the subject of indirect transfer.

Articles 13(4), 13(5) and 13(6) would have a bearing as far as taxation of indirect transfers are concerned. They are as under:

13(4) Gains from the alienation of shares of the capital stock of a company, or of an interest in a partnership, trust or estate, the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State. In particular:

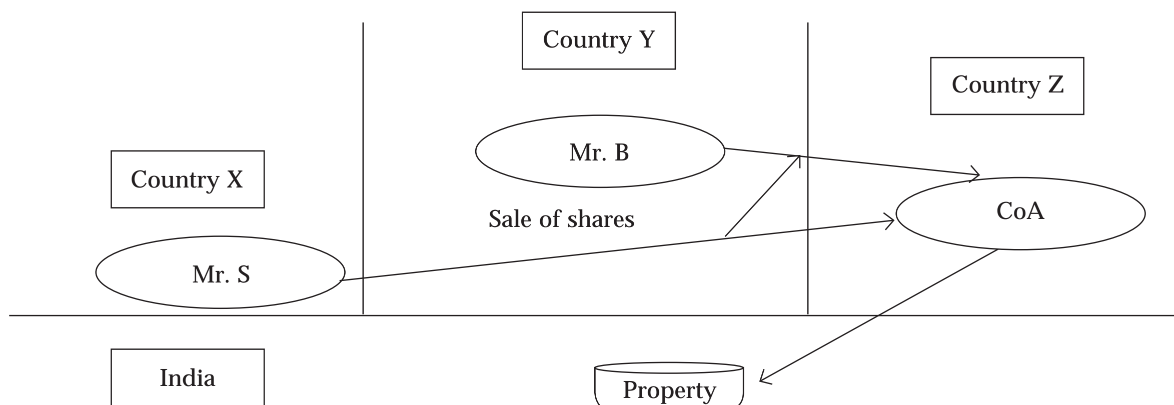
(a) Nothing contained in this paragraph shall apply to a company, partnership, trust or estate, other than a company, partnership, trust or estate engaged in the business of management of immovable properties, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, trust or estate in its business activities.

(b) For the purposes of this paragraph, "principally" in relation to ownership of immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by the company, partnership, trust or estate.

5. Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 12-month period preceding such alienation, held directly or indirectly at least ___ per cent (the percentage is to be established through bilateral negotiations) of the capital of that company.

6. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident State" (emphasis supplied)

Para (4) is a distributive rule covering indirect transfer of immovable property. This can be illustrated as under –



The extreme possibilities are considered here. Company A, resident of State Z, has invested in an immovable property situated in India. Co A has no other assets. Mr S is a sole shareholder of the Co A and he is resident of State X. Mr. S sells the share of Co. A to Mr. B, a resident of State Y. Both Mr. S and Mr. B are non-residents in India. Applicable treaty in this case is the DTAA between India and State X based on UN MC. Under Article 13(4), India will have a right of taxation, even if there is no direct transfer of assets in India.

It is clear that a provision such as Article 13(4) is targeted at preventing a rule-shopping tax planning tool already addressed by several states in their treaty practice. The purpose of Article 13(4) is to put the alienation of shares in immovable property companies and the alienation of the underlying immovable property on an equal footing from a treaty regime perspective. However, it is important to note that the prevention aspect pertains to the real estate sector only.

Article 13(6) is a residuary clause that deals with alientation of property not dealt with the earlier clauses. Hence the clause that one needs to really interpret is Article 13(5).

Sanofi Pasteur Holding case

Just like the Vodafone case is like a complete code dealing with the provisions of the domestic law on indirect transfer, the provisions relating to indirect transfers as per Article 14(5) of the India-France treaty (which is similar to article 13(5) of the UN Model Convention) came up for interpretation before the Andhra Pradesh High Court in the case of *Sanofi Pasteur Holdings SA vs. Department of Revenue (354 ITR 316).* Two French companies named "Meriux Alliance" ('MA') and "Groupe Industrial Marcel Dassault" ("GIMD") held shares in another French company named "ShanH". MA & GIMD acquired shares in an Indian company named "Shantha Biotechnics Ltd." ("Shantha") through the above intermediary company called Shan H. MA and GIMD subsequently sold the shares in ShanH to another French company named "Sanofi Pasteur Holdings". The tax department sought to tax the transfer on the ground that the French company's (ShanH) only asset were the shares in the Indian company & so when its shares were sold, what really was transferred were the underlying assets and the control of the Indian company and so the French intermediary company Shan H was a facade and a scheme for avoidance of tax.

After concluding that the intermediary company ShanH had commercial substance, the AP High Court held as under :

a) Article 14(5) of the India-France DTAA which exempts capital gains from shares representing more than 10% holding from tax in India did not permit a see through on whether the alienation of shares by ShanH is an alienation of the control, management or assets of the Indian company. It cannot be said that an actual alienation of the ShanH shares amounts to a deemed alienation of the Indian company's shares. The fact that the value of the shares of ShanH was because of the value of the Indian company's assets was irrelevant;

b) The retrospective amendment to s. 9(1) so as to supersede the verdict in Vodafone and to tax off-shore transfers does not impact the provisions of the India-France DTAA because the DTAA overrides the Act;

c) The Revenue's argument that as the term "alienation" is not defined in the DTAA, it should have the meaning of the term "transfer" in Section 2(47) as retrospectively amended is not acceptable because as per Article 31 of the Vienna Convention, a treaty has to be interpreted as per good faith and in accordance with the ordinary meaning. Though Article 3(2) provides that a term not defined in the treaty may be given the meaning in the Act, this is not applicable because the term "alienation" is not defined in the Act. In some DTAAs, the term "alienation" is defined to include the term "transfer" but not in the India-France DTAA;

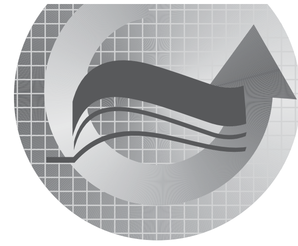
(d) Even assuming that the controlling rights or assets in India held by the Indian company were transferred on the alienation of the French company's shares, the cost of acquiring those rights and assets in the Indian company and their date of acquisition cannot be determined. It is also not possible to determine the exact or rationally approximate consideration (out of the total consideration for the transaction in issue), which can be apportioned to these assets/ rights. As the computation provisions fail, the charging provisions also fail.

Thus on the basis of the ruling one can argue that indirect transfers in case of countries where the treaty has a similar wording would be exempt from tax in India. The Sanofi ruling is thus a landmark ruling as far as this subject is so concerned.

Conclusion

Thus as one may note in spite of the far reaching and wide amendments made by the Finance Act, 2012 in the domestic law, the final word on the subject has not yet been spoken. The introduction of GAAR from April 2015 may further queer the pitch as it will add a tool in the power of the Revenue to deny treaty relief when such provisions are invoked. Indeed as tax consultants, we will continue to have interesting times ahead of us.

> He whom the gods love dies young, while he is in health, has his senses and his judgments sound.
>
> — *Plautus*



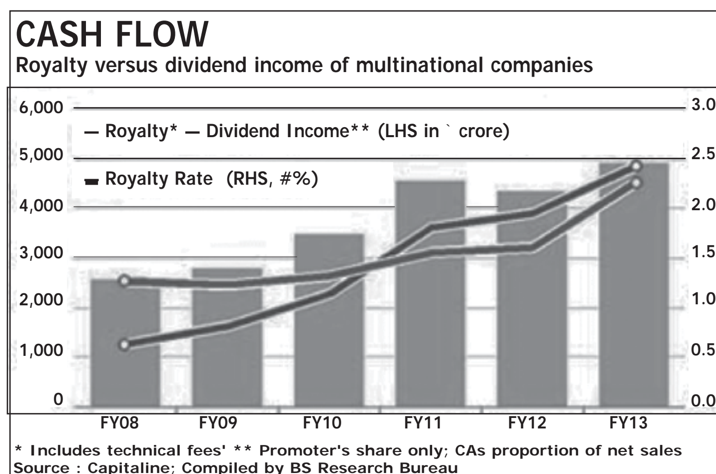
CA Vispi T. Patel & CA Rajiv G. Shah

Royalties and Fees for Technical Services – Recent Developments

Introduction

The world has evolved to become a global village, due to technological advancement, especially in the fields of communication and information technology. Geographical distances between the countries have become irrelevant for international trade, especially in rendering of services. Globalisation, has thus increased cross border trade and investments. More and more multinational companies (MNCs) have increasingly set up their operations in developing countries. The necessary corollary to this is transfer of technology from the developed countries to the developing countries and the payments towards such transfer. The common and widely used form of such transfer is the provision of services, transfer of technology, through transfer of patents, technical skill, knowledge, information, design etc., permitting the use of brands, trade name, logo etc. With the liberalisation of dealing in foreign exchange, it has been witnessed that the payments towards royalty and fees for the use of the technology by the MNCs' operating in India have increased manifold.

"In the past five years, royalty payments by MNCs have grown at a compound annual growth rate (CAGR) of 31.1 per cent yearly, much faster than rise in revenue and profit", says Krishna Kant Associate Editor at Business Standard in an article dated January 18, 2014[1].



1 http://www.business-standard.com/article/companies/royalty-bigger-than-dividends-for-mncs-114011701117_1.html

This demonstrates the economic significance of royalty/ fees for technical services (FTS) as far as MNC's operating in India are concerned and also its relevance from a tax perspective.

The article deals only with the recent developments and the taxation of royalties and FTS earned in India by the non-residents. It includes important legislative amendments and some important judicial pronouncements on royalty and FTS, which lay down some important guidelines and having a bearing on the taxation in India.

Statutory Provisions

The provisions relating to the taxation of the royalty and FTS earned by non-residents are covered by sections 9(1)(vi) and 9(1)(vii) of the Income-tax Act, 1961 (Act). It deals with the source rules i.e. when the payment towards royalty and FTS is deemed to accrue or arise in India even though the transaction may take place outside India and the royalty/FTS may also be rendered/ accrue outside India. It also defines the term "Royalty" and "Fees for technical services" i.e. what is the meaning of the term; what can be regarded as royalty and FTS; and hence governed by the relevant provisions of the Act. It may be noted that section 9 of the Act deals with the circumstances under which the income is deemed to accrue or arise in India. It may also be noted that under section 5 of the Act a non-resident is liable to tax in India in respect of his income which:

- is received or deemed to be received in India or
- accrues or arises in India or is deemed to accrues or arises in India.

Explanations 4, 5 and 6 to section 9(1)(vi) have been inserted vide Finance Act, 2012 with retrospective effect from the 1st day of June, 1976. The explanations have been inserted to explain the meaning of the term "Royalty". The explanations have been sought to be inserted for the purpose of removal of doubts. Thus, according to the legislature, the amendments merely clarify the position and the term royalty has always included the things sought to have been included by way of explanations. The memorandum explaining the provisions of the Finance Bill, 2012 have regarded the provisions as rationalisation of international taxation. The memorandum provides as under:

"Section 9(1)(vi) provides that any income payable by way of royalty in respect of any right, property or information is deemed to be accruing or arising in India. The term "royalty" has been defined in Explanation 2 which means consideration received or receivable for transfer of all or any right in respect of certain rights, property or information. Some judicial decisions have interpreted this definition in a manner which has raised doubts as to whether consideration for use of computer software is royalty or not; whether the right, property or information is to be used directly by the payer or is to be located in India or control or possession of it has to be with the payer. Similarly, doubts have been raised regarding the meaning of the term process.

Considering the conflicting decisions of various courts in respect of income in nature of royalty and to restate the legislative intent, it is further proposed to amend the Income-tax Act."

Only time will tell whether the amendments sought to overcome the judicial pronouncements are effective enough to overcome the same and would achieve the objectives for which they have been enacted. Questions could also be raised about its nature as clarificatory and its application with retrospective effect.

Almost all agreements for avoidance of double taxation (treaty) entered into by India deal with income from royalty, and barring a few also deal with income from FTS. They define the term royalty and FTS. By virtue of section 90(2) of the Act, a non resident has the option to be governed by the provisions of the Act whenever they are beneficial. It may be noted that if any term is used in the Act and the treaty and if the same is neither defined in the Act or in the treaty, the same has to be understood

in consistency with the provisions of the Act and the treaty, unless the context otherwise requires. However, when there is a difference in the definition of a term between the Act and the treaty, it is obvious that the treaty definition of the term royalty or FTS would override the definition in the Act if the same is beneficial to the taxpayer. Hence, the amendments which sought to expand the definition of the term royalty in the Act will not have any impact on the non-resident governed by a treaty till the treaty definition is also amended accordingly or the treaty definition already has the said element of the term 'royalty'.

The Delhi High Court in the case of Infrasoft Ltd. (infra) has held that the payment towards purchase of software not to be royalty within the meaning of the term under the treaty. The Hon'ble Court refused to look at the amendment in the Act since the provisions of the treaty were beneficial to the taxpayer. The Andhra Pradesh High Court in the case of Sanofi Pasture Holdings SA[2] held that retrospective amendments made by the Finance Act, 2012 were not fortified by a 'non-obstante' clause expressed to override tax treaties and hence the same will not override the treaties.

Considering the view of the Hon'ble High Courts and the legislative intent of amendments to the Act, it would be interesting to see the interpretation courts will place taking into account the relevant treaty provisions.

Amendment to Section 115A of the Act by the Finance Act, 2013

Section 115A of the Act provides for the taxation of royalties and FTS which is not effectively connected with permanent establishment (PE) of the non-resident in India on gross basis; subject to compliance of certain conditions. The Act provides for different rates depending on the date on which the agreement in pursuance of which the royalty/FTS was paid. The rate of tax which was 10% in respect of an agreement entered into after 1st June, 2005, has been increased to 25% by the Finance Act, 2013. The amended rate of tax is applicable irrespective of the date of the agreement. The memorandum explaining the provisions of the Finance Bill, 2013 explains the rationale for the increase as under:

"India has tax treaties with 84 countries, majority of the tax treaties allow India to levy tax on gross amount of royalty at rates ranging from 10% to 25%, whereas the tax rates as per section 115A is 10%. In some cases, this has resulted in taxation at lower rate of 10% even if the treaty allows the income to be taxed at higher rate."

The latest treaties which India has negotiated generally provide for taxation of royalties/FTS at 10% on gross basis and thus the rationale is not in sync with the said amendment. Further, the taxation on gross basis at 25% *per se* is on the higher side which will increase the cost of import of technology.

Further, it is obvious that the above amendment will not have any impact on the non-residents where the relevant treaty rate is lower than 25%.

Judicial Pronouncements

Legal principles are enunciated and embodied in judicial decisions of various appellant/ judicial authorities. So let us understand some recent judicial pronouncements so as to unravel the thread of interpretation.

US Technology Resources Pvt. Ltd.[3]

This is a very peculiar decision where after examining the agreement for rendering of services, the Income-tax Appellant Tribunal

2 M/s.Sanofi Pasteur Holding SA vs The Department of Revenue [W.P.Nos. 14212 of 2010, 3339 and 3358 of 2012 (Andhra Pradesh HC)]

3 US Technology Resources Pvt. Ltd. v. ACIT [ITA No.222/Coch/2013, AY 2007-08, ITAT-Cochin] / [2013-TII-200-ITAT-COCHIN-INTL]

(Tribunal) regarded the managerial services as technical in nature and also regarded the same as made available to the recipient of technical knowledge, skills or experience, etc.

As upheld by the Tribunal, the manner in which the managerial services were ultimately regarded as being technical in nature, probably in the era of technological advancement, it could lead to all such services being regarded as technical in nature, though as per common understanding they could not be so regarded.

Facts

The taxpayer was engaged in the business of providing software development services to its customers in India. The taxpayer entered into a 'management service agreement' with the non-resident company (US company) for obtaining management services. As per the terms of the agreement, the non-resident company provided assistance, advice and support to the taxpayer in management, decision making, sales and business development, financial decision making, legal matters and public relations activities, treasury service, risk management service and any other management support service.

The revenue authorities relied on decision of Andhra Pradesh High Court (HC) in the case of GVK Industries Ltd.[4] where it was held that the advice given by a company in taking a financial decision would be a technical or consultancy service; and hence, liable for withholding of tax at source as FTS.

Observations and arguments

The Tribunal observed that the term 'managerial service' did not find place in Article 12(4) of the India-USA DTAA (DTAA or treaty). As per Article 12(4) of the DTAA, technical as well as consultancy services are considered as 'included services' only to the extent that it made available technical knowledge, skill, know–how or process. However, on perusal of Memorandum of Understanding (MOU) under the treaty, it indicates that if technical knowledge, experience or skill is made available, then it would be considered as technical or consultancy services. It was obvious that the non-resident provided highly technical services which were used by the assessee for taking managerial decision, financial decision, risk management decision, etc.

Science is a fact based, critically tested, systematised body of knowledge pertaining to a specific field. The knowledge is accumulated through study, experience and experimentation. Scientific knowledge produces impersonal results and it can be empirically tested and universally applied. In the era of technology transformation, the information / experience gathered by the non-resident relating to financial risk management of business is technical knowledge.

The Tribunal further observed that apart from providing advice, the non-resident also provided training to the employees of the taxpayer. Therefore, in the context of professional management and decision making process, the advice and service rendered by the non-resident which was made use by the assessee in managerial decision making process was in the nature of technical services which facilitated the taxpayer to take correct and suitable decision towards achievement of the desired objects and business goal. Therefore, it was not correct to say that what was received by the assessee is only a managerial advice and not technical advice.

Thus, the Tribunal based on the above observations held that the service of technical input, advice, expertise, etc. rendered by the non-resident was technical in nature as provided in clause 4(b) of Article 12 of the DTAA.

M/s United Helicharters Pvt. Ltd.[5]

This decision highlights that the training to pilots/ engineers was given as per the rules

4 G.V.K Industries Ltd. vs. Income-tax Officer [1997] 228 ITR 564 (AP) HC

5 United Helicharters Pvt Ltd vs. ACIT (ITA No. 5136 and 5135 of 2011) / [2013-TII-161-ITAT-MUM-INTL]

framed by the Directorate General of Civil Aviation of India (DGCA) which were only a part of eligibility for working in the aviation industry and thus, in each and every case it may not make available the technical skills, knowledge, etc. Further, what is important and needs to be looked into, is the purpose and the person to whom the training is imparted.

Facts

The assessee company was engaged in the business of charter hire of helicopters. The assessee had not deducted tax at source while making payment towards training expenses paid to Bell Helicopter Textron Inc., a resident of USA. The training for maintenance and flying operation staff was conducted abroad and the USA company had no place of business in India. The agency provided the training as per the rules framed by DGCA. Following the training, and the certificate issued by the agency, the pilots or engineers were enabled to get their licenses endorsed, to operate the specified type of helicopter.

The AO disallowed the amounts paid on account of training expenses on account of non-deduction of tax in India and thus, held that the payment made by the assessee was FTS and liable to tax in India.

Observations and arguments

As per Article 12(4)(b) of Indo-US DTAA, fees for included services (FIS) includes such services which make available technical knowledge, experience, skill, etc. or consist of the development and transfer of a technical plan or technical design. The training in the case in hand was given to the pilots and other staff as per the rules framed by DGCA. The Tribunal thus deleted the addition made by AO on the ground that it was only a part of the eligibility of the pilots and other staff for working in the aviation industry and such training would not fall under the term 'service make available'.

Sargent & Lundy[6]

This decision highlights the various factors that may be relevant in determining the fact that whether the technical knowledge, skill etc. has been made available to the recipient of the services.

Facts

The taxpayer, a US resident, was a consulting firm engaged in providing services to the power industry in the nature of operating power plants, decommissioning consulting, project solutions and other engineering based services. The taxpayer entered into an agreement with L&T Ltd (L&T) for rendering consulting and engineering services in relation to ultra-mega power projects (projects) in India. The taxpayer was required to technically review and evaluate the projects and prepare necessary designs and documents.

The AO was of the view that the above services were technical in nature and accordingly, were taxable as FTS under the Act as well as under the India-US DTAA (DTAA). On the contrary, the taxpayer contended that the services did not make available technical knowledge to the payer as envisaged under DTAA and hence not taxable in India. Further, the taxpayer nowhere disputed for the taxability of the above services as FTS under the Act.

Observations and arguments

The Tribunal observed that the taxpayer, as per the agreement with L&T, rendered technical services in the shape of technical plans, designs, projects etc. which were nothing but blueprints of the technical side of the mega power projects. Such services were rendered at a pre-bid stage. It was thus, quite natural, that such technical plans etc. were meant for use in future, if and

6 [ITA No. 8986/Mum/2010] / [2013-TII-124-ITAT-MUM-INTL]

when, L&T takes up the bid for installation of the projects. The technical services provided by the taxpayer were of such nature, which were capable of use in future alone, thus, the same would satisfy the test of 'make available' as envisaged under the DTAA. Further, it was observed that the mere nomenclature of 'consulting and engineering services' cannot be determinative of the real character of the services. The true nature of services can be culled out only from the examination of the duties assigned to and done by the assessee.

Based on the above observations, it was held by the Tribunal that the services rendered by the taxpayer would qualify as FIS and were, therefore, taxable in India.

Infrasoft Ltd.[7]

This is a very important judgment from the Delhi HC on the characterization of income on grant of a license for use of software after the amendments made by Finance Act, 2012. The judgment has deliberated the earlier decisions on the subject, extensively discussed the distinction between copyright rights and copyrighted article and it has expressly disagreed with Karnataka HC judgment in case of Samsung Electronics[8].

The question before the HC was 'whether the Tribunal was right in holding that the consideration received by the taxpayer on grant of license for use of software was not royalty within the meaning of Article 12(3) to the India-USA DTAA?'

Facts, observations and arguments

The High Court observed that as per the Licensing Agreement the licence was non-exclusive, non-transferable and the software was to be used in accordance with the agreement. Only one copy of the software was being supplied for each site. The licensee was permitted to make only one copy of the software and associated support information and that also for backup purposes. It was also stipulated that the copy so made shall include Infrasoft's copyright and other proprietary notices. All copies of the software were the exclusive property of Infrasoft.

It was observed that a non-exclusive and non-transferable licence enabling the use of a copyrighted product cannot be construed as an authority to enjoy any or all of the enumerated rights ingrained in Article 12 of the India-USA DTAA. Where the purpose of the licence or the transaction was only to restrict use of the copyrighted product for internal business purpose, it would not be legally correct to state that the copyright itself or right to use copyright has been transferred to any extent. Distinction has to be made between the acquisition of a "copyright right" and a "copyrighted article". Copyright is distinct from the material object, copyrighted. Copyright is an intangible incorporeal right in the nature of a privilege, quite independent of any material substance, such as a manuscript. Copyright or even right to use copyright is distinguishable from sale consideration paid for "copyrighted" article. This sale consideration is for purchase of goods and is not royalty.

The High Court observed that Supreme Court in the case of Tata Consultancy[9] held that software may be intellectual property, contained on a medium and was a marketable commodity and an object of trade and commerce. A software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that programme may remain with the originator of the programme. But the moment copies are

7 DIT v. Infrasoft Ltd. (ITA No. 1034/2009) / [2013-TII-50-HC-DEL-INTL]
8 CIT v. Samsung Electronics Co. Ltd. [2012] 345 ITR 494 (Kar)
9 Tata Consultancy Services v. State of Andhra Pradesh [2004] 271 ITR 401 (SC)

made and marketed, it becomes goods, which are susceptible to sales tax.

Further intellectual property, once it is put on to a media, whether it be in the form of books or canvas (in case of painting) or computer discs or cassettes, and marketed would become 'goods'. There is no difference between a sale of a software programme on a CD/floppy disc from a sale of music on a cassette/CD or a sale of a film on a video cassette/CD. In all such cases, the intellectual property has been incorporated on a media for purposes of transfer.

The High Court distinguished the Karnataka High Court decision in the case of Samsung Electronics (supra) and held that the licence granted to the licensee permitting him to download the computer programme and storing it in the computer for his own use was only incidental to the facility extended to the licensee to make use of the copyrighted product for his internal business purpose. The said process was necessary to make the programme functional and to have access to it and is qualitatively different from the right contemplated by the said provision because it is only integral to the use of copyrighted product.

The High Court also observed that the licensee was allowed to use the software only for its own business as specifically identified and was not permitted to loan / rent / sale / sub-licence or transfer the copy of software to any third party without the consent of Infrasoft. The licensee has been prohibited from copying, decompiling, de-assembling, or reverse engineering the software without the written consent of Infrasoft. The licence agreement stipulates that upon termination of the agreement for any reason, the licencee shall return the software including supporting information and licence authorization device to Infrasoft.

The High Court based on the above held that there was no transfer of any right in respect of copyright by the taxpayer and it was a case of mere transfer of a copyrighted article. The payment was for a copyrighted article and represents the purchase price of an article and cannot be considered as royalty either under the Act or under the India-USA DTAA.

However, the High Court has not examined the effect of the retrospective amendment to section 9(1)(vi) of the Act and also whether the amount received for use of software would be royalty in terms thereof, as the taxpayer was covered by the DTAA, the provisions of which were more beneficial.

Right Florists Pvt Ltd.[10]

The Kolkata Tribunal has outlined, amongst others, various principles for interpreting income which accrues or arises in India and India's reservations/observations on the OECD commentary, which could be relevant in determining the taxability of income in India. Further, this decision of the tribunal has dealt with the question whether a website can be regarded as a permanent establishment. It reiterated the view that if services are to be regarded as technical, human intervention is a necessary ingredient.

Facts

The taxpayer a Kolkata based florist used the online search engine of Google Ireland Limited, Ireland (Google) and Overture Services Inc, USA (Yahoo) for advertising and generating business. Google and Yahoo, own search engine websites and the advertising was done on the results generated by the search results against agreed keywords or by placing the advertisement

10 ITO v. Right Florists Pvt Ltd (ITA No. 1336/Kol/2011) / [2013-TII-61-ITAT-KOL-INTL]

banners on websites.

The taxpayer made payments to Google and Yahoo for its online advertisements, without deducting taxes under section 195 of the Act. The AO disallowed the advertisement expenses under section 40(a)(ia) of the Act, as the taxpayer failed to deduct tax or approach the AO under section 195 of the Act, before making payments to non-residents. On appeal, the Commissioner of Income-tax appeals allowed the assessee's appeal holding that no tax was deductible on such payment.

Observations and arguments

Whether presence through a website constitutes a PE?

In traditional commerce, physical presence was required in the source country if any significant level of business was to be carried on, but, with the development of internet, telecommunication, etc. the extent of physical presence in the source country has virtually vanished in many businesses, especially where data can be digitised. The search engine's presence in a location, other than the location of its effective place of management, is only on the internet or by way of a website, which is not a form of physical presence.

Conventional PE tests fail in this virtual world even when a reasonable level of commercial activity is crossed by foreign enterprises in the source state.

A search engine, which has only its presence through its website, cannot be treated as PE unless its web servers are also located in the same jurisdiction which is not the situation in the present case.

Further, the Tribunal held that India's reservations on "website PE" in the OECD commentary are not relevant in judicial analysis.

Relying on the High Powered Committee report and the Commentary on OECD Model Convention, the Tribunal held that *"a website per se, which is the only form of Google's presence in India – so far as the test of primary meaning i.e. basic rule PE is concerned, cannot be a PE under the domestic law".*

Whether human intervention is required to render technical services?

A managerial or consultancy service can only be rendered with human interface, while technical service can be rendered with or without human interface. When we try to restrict the meaning of technical services to the services which are covered by managerial and technical services as well, services without human interface will have to be taken out of its ambit.

Further, there was no dispute that in the services rendered by the search engines, there is no human touch involved, the results are completely automated. Accordingly in the present case, there was no transfer of any technology and as such, payments for such services were outside the ambit under Article 12 of the India-USA DTAA. Therefore, the payments made to Yahoo could not be brought to tax in India.

Verizon Communications Singapore Pte Ltd.[11]

The judgment held that the payment towards use of international private lease circuit as royalty for use of equipment / process. It has discussed various technical aspects of the business and various earlier decisions on the same / similar subject. It also relied on the amendments made by the Finance Act, 2012 to arrive at its conclusion. Unfortunately, there is not much discussion as regards how the payment would be regarded as royalty under the treaty.

11 Verizon Communications Singapore Pte Ltd. v. ITO [2013] 39 taxmann.com 70 (Mad) / [2013-TII-48-HC-MAD-INTL]

Facts

The assessee, Verizon Communication Singapore Pte Ltd, is a non-resident company engaged in the business of providing international private leased circuit (IPLC). Being a point to point private line used to communicate between offices that are geographically dispersed throughout the world, the assessee provides a private link that can transport voice data and video traffic between the offices in different countries. The international leg of the telecom services provided outside India was provided by the assessee. Videsh Sanchar Nigam Limited (VSNL) provided the Indian leg of the international service to the customers. Thus, a customer interested in taking a lease connection between its office in India and an overseas location entered into an arrangement with the assessee for the provision of international connectivity in the overseas leg and with VSNL for Indian half of the connectivity. VSNL transmitted the traffic of the customer in India from the customer's office in India and transmitted the traffic to a virtual point outside India and the assessee transmitted it upto the customer location outside India. Assessee used its telecom service equipment situated outside India in providing the international half circuit. The landing station in India used in transmitting the traffic within India belonged to VSNL and was used by VSNL for providing Indian end services pursuant to its contract with the customer.

In assessment, the Assessing Officer came to the conclusion that the payment received by the assessee in providing IPLC was taxable as 'royalty' for use of or right to use of commercial and scientific equipment under Section 9(1)(vi) read with Explanation 2 of the Income-tax Act and Article 12(3) of the treaty between India and Singapore.

The main contention of the assessee was that no part of the international network was exclusive for any Indian customer or customers as a whole. The agreement between the assessee and the customers being one for rendering of service by the assessee, the payment could not be termed as 'royalty'. The collection of fee for the usage of standard facility would not amount to payment made for providing technical services.

Observations and arguments

The amendments by insertion of Explanation 5 gives a very expansive meaning to the term 'royalty' and this has a bearing on the issues to the various clauses in the agreements which are to be looked at in a holistic manner. The agreement entered into between the assessee and the customer herein is for providing of seamless point to point private line so as to enable the customer to communicate between its office that are geograhically dispersed. The service order reveals that the parties had agreed for a particular bandwidth and in entering this, the assessee had provided the necessary equipment at customer premises, configured and customised to ensure that the customer gets the uninterrupted connectivity from one end to the other end in different geographical point.

A reading of the agreement with VSNL also shows that the configuration at the customer's end and at the VSNL end and in the other half managed by the assessee match with each other and compatible for ensuring the integrated service to the customer. The arrangement between the assessee and the VSNL has to be necessarily integrated and technically and financially viable having regard to the close functional relationship between the two. For this, the Indian customer pays through the single billing system called OSS for the integrated services. Thus the service agreement assuring the service is possible and workable only when the assessee and VSNL are considered as rendering the service jointly in their respective leg. Thus the two half being the mirror image of each other and going by the terms of the agreements, the assessee renders service in India and the

consideration received attracts the incidence of taxation in India.

In the background of the clauses in the agreement, the Customer Premises Equipment at the customer's location and Schedule- B on Additional terms for Co-Location Services, it is difficult to hold that there is no use of any equipment - scientific/commercial. There is use of equipment and cable in the transmission of the data/voice from one end to the other and it is difficult to accept the case of the assessee that the nature of transaction is only that of service. The agreement provides an indefeasible right to the customer to use the facility of communicating the data/voice and has an internet in the matching half circuits for providing the required telecommunication services at the assured speed. Thus the efficacy of transmitting data/voice depends on the originating signal from the customer end which means there is the use of the equipment CPE by the customer installed by the assessee. In the circumstances, we reject the argument of the assessee that it merely provided the service to the customer and that the consideration could not be termed as royalty.

After the insertion of Explanation 5, possession, control of such right, property or information usage directly by the payer, location of the right are not matters of concern in deciding the character of payment as 'royalty' and but for the use of the connectivity by the payer, the service agreement itself has no meaning. Thus the amendments introduced clearly answer the question raised in this regard against the assessee.

The definition of 'royalty' under DTAA and the Act are in pari materia. As rightly pointed out by the revenue authorities, Explanation 6 to section 9(1)(vi) defines 'process' to mean and include transmission by satellite (including uplinking, amplification, conversion for downlinking of any signal) cable, optic fibre, or by any other similar technology, whether or not such process is secret. Thus, apart from the relevance and applicability of Clause (iva) that the payment is for the use or right to use of the equipment, the Tribunal held that payment for the bandwidth amounts to royalty for the use of the process. The Tribunal also pointed out that by reason of the long distance, to maintain the required speed, boosters are kept at periodical intervals. Going by this too, in any event, the payment received by the assessee was rightly assessed as 'royalty' and would constitute so for the purposes of DTAA.

Temasek Holdings Advisors (I) P Ltd.[12]

This decision has reaffirmed various earlier judicial pronouncements that if the foreign company has already withheld and remitted tax under section 192 of the Act from the salary paid to the seconded employees in India, any reimbursement made by the Indian company towards the salary cost would not attract section 195 of the Act, if the foreign company did not render any services to the Indian company.

Facts

The taxpayer, a wholly owned subsidiary of Temasek Holdings Pte Ltd (THPL), Singapore was engaged in rendering investment advisory services to THPL, which included identifying, analyzing potential investments in India and making recommendation to THPL. THPL had seconded two of its employees to the taxpayer under a secondment agreement to work exclusively for the taxpayer under the supervision and control of the board of directors of the taxpayer. During the period of secondment, the employees continued to be on the rolls of THPL; the salary of the seconded employees was to be paid by THPL and the

12 Temasek Holdings Advisors (I) P. Ltd. v. DCIT (ITA No. 4203/ Mum/ 2012) / [2013-TII-163-ITAT-MUM-INTL]

taxpayer had to reimburse the cost of the salary and other expenses relating to the employment. THPL deducted tax under section 192 of the Act and deposited the same in accordance with the Act;

The Assessing Officer regarded the payment made by the taxpayer towards reimbursement of the salary to THPL as FTS and disallowed the same since no further tax was deducted from the same.

Observations and arguments

The Tribunal observed that there could not be double withholding of taxes - once at the time of payment of the salary and again on reimbursement made by the assessee to THPL. The two seconded employees worked only for the Indian company and were not rendering services on behalf of THPL. Since the seconded persons were the employees of Singapore company, the payment of salary and cost of the expenditure in terms of appointment letter has been borne by the Singapore company.

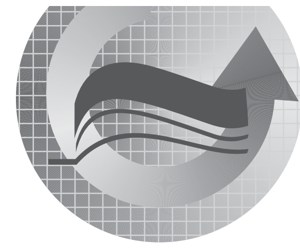
While doing so, it had withheld the taxes and deposited the sum under the provisions of section 192 of the Act with the Government of India treasury. Thus, the payment of salary had already been subjected to TDS. The Indian company which rendered services for Singapore company had utilized the services of these seconded employees for their Indian operation. The secondment agreement clearly provided that these two employees will work for the assessee company under the control and supervision of the Board of Directors of the Indian company. Their services can be terminated by the either party and the salary which is borne by the employer (Singapore company), the entire cost of salary would be reimbursed by the assessee company. Accordingly, the disallowance under section 40(a)(ia) on account of these expenses were deleted.

Conclusion

It is said that tax treaties reflect the country's general policies towards cross-border trade. The provisions in the treaty determine the flow of capital and technology by facilitating their flow. The taxation of royalty and fees for technical services is, and will continue to be an important issue for consideration for business. The issue of taxability of such incomes, both at the international level and at the domestic level, is far from settled and continues to be a constant source of litigation.

The interpretation that Indian courts/ Revenue officials have taken of what constitutes royalty/ FTS will have an obvious effect on business. In the field of copyrights too, India has its reservations. For instance India considers 'network licenses' which permit the licensee to make multiple copies of the programme for use only within the enterprises computer network, (e.g. transfer onto user's computer hard drive) as royalties whereas the OECD does not consider these as royalties.

India aims 'to facilitate its development as a global hub for manufacturing, trading and services'. India thus, needs to bring clarity for business, by harmonising its domestic tax laws with that of the various treaties that it has entered into. As India is a developing economy, its needs to attract advanced technology and foreign direct investment (FDI), hence pragmatically its tax laws and tax administrations need to keep these twin objectives in mind.



CA Tarunkumar Singhal

Current Issues in International Taxation relating to certain payments

There has been an incessant flow of decisions by the Indian Courts in the arena of International Taxation and Transfer Pricing in recent years so much so that even a specialist finds it strenuous to keep pace with the flow and reconcile various bewildering and conflicting decisions. It is estimated that 50% of decisions in the field of International Taxation pertain to taxation of Royalties and Fees for Technical Services (FTS). In this article, an attempt has been made to select and discuss some important issues concerning taxation of Royalties and FTS with a view to apprise the reader with various emerging issues/controversies so that adequate care is taken to deduct appropriate tax while making remittance of Royalties and FTS to a Non-Resident so as to avoid disallowance u/s. 40(a)(i). Since the subject is very dynamic, the reader would be well advised to study these and other decisions on the subject in detail before taking a view about taxability of a particular payment and deciding about quantum of tax to be deducted.

1. Taxability of payment of export commission

ITO vs. Device Driven (India) Pvt. Ltd. (2013-TII-214-ITAT-Kochi-Intl)

There have been scores of Tribunal and High Court decisions holding that Export Commission earned by a Non-Resident Service Provider in respect of services provided to an Indian Exporter outside India is not taxable in India either as Business Profits (in the absence of a PE) or as "Fees for Technical Services". However, the Kochi Tribunal in the case of Device Driven India Pvt. Ltd. held, on the specific facts of the case that the payment made to the Non-Resident Service Provider (SP) was taxable both under the Act as well as under Article 14 of India-Switzerland DTAA. Let us discuss this interesting case.

However, in a recent ruling of the Kochi Tribunal in the above case, on the issue of taxability of Export Commission earned by a non-resident (NR) Service Provider (SP) from outside India when such SP was also a director of the Assessee Company, the Tribunal noted that the SP was responsible for securing orders and to assist the assessee in all respects including identifying markets, making introductory contacts, arranging meeting with prospective clients, assisting in preparation of presentations for target clients, etc. Accordingly, the services rendered cannot be treated as "pure" commission-based services but were in the nature of technical services chargeable as such, under the Indian Tax Act (ITA). Further, the SP was a director of the assessee and the office of the assessee in India could be treated as a "fixed base" regularly available to the SP

for the purposes of Article 14 of the India–Switzerland DTAA dealing with Independent Personal Services. Therefore, payment to the SP was taxable in India both under the ITA and the DTAA and, accordingly, the assessee was required to withhold taxes.

In view of the importance of the subject in day to day practice, let us discuss the case in greater detail:

Facts in brief

The assessee, an Indian company, was engaged in the development and sale of software. The assessee paid export commission to the SP who was tax resident of Switzerland. The Assessee contended that the services rendered by the SP were for marketing assistance/support and guidance for securing orders from overseas clients and not for rendering any technical expertise/services. Reliance was placed on certain Circulars of the Central Board of Direct Taxes to contend that pure export commission earned by a person for rendering services outside India would not be taxable in India.

The Tax Department contended that the SP is technically qualified and highly experienced in the software business. Considering the vast experience and technical knowledge, the services rendered by the SP were technical in nature and beyond what a normal commission agent would have rendered.

Accordingly, the same was taxable under the Income-tax Act as Fees for Technical Services (FTS).

As the SP was required to hold regular meetings for monitoring the progress and status of the projects undertaken by the Assessee in India, the Tax department concluded that the Assessee would have provided a fixed base in the form of office to the director, which triggered tax under Article 14 of the DTAA.

Decision

The Tribunal upheld the contentions of the Tax Department as follows:

- The nature of responsibilities and obligations placed on the director is significantly higher than what would have been placed upon a pure commission agent working in normal business transactions.
- Customised software is a highly technical product, which is developed in accordance with the requirements of the customers. Even after the development, it requires constant on-site monitoring so that necessary modifications are carried out in order to make it suitable to the requirements.
- Unlike sale of commodities, the role of the commission agent is not limited, but technical knowledge is required to understand the needs of the clients, to procure orders.
- To identify markets, making introductory contacts, arranging meeting with prospective clients, assisting in preparation of presentations for target clients, monitor the status and progress of the project, etc. – all these activities could be carried on only by a person who has vast technical knowledge and experience. Accordingly, the services rendered are technical in nature and the fees paid are towards technical services.
- As the SP is a director in the Assessee and also the sole foreign marketing agent, he has the responsibility to take care of business interests of the Assessee. As a director, the SP has every right to look into and is also required to take care of the affairs of the Assessee.
- Further, the certificate/affidavit given by the Assessee confirming that it has not provided any fixed base to the SP cannot be of any help due to the closeness of the SP with the Assessee. Therefore, there is no infirmity in the Tax department's view that the Assessee must have provided a

"fixed base" to the SP. Hence, the office of the Assessee can conveniently be treated as a fixed base for the SP.

- Accordingly, payment to the director is taxable in India and warrants tax withholding. As the Assessee failed to withhold taxes, the payment is to be disallowed while computing its taxable profits.

Though the above decision is very fact specific, it indicates that the payer and his consultant should carefully evaluate the scope of functions, responsibilities and obligations of the foreign agent before concluding that the services are "pure" export commission-based services so as to qualify as commercial income beyond the scope of taxation as FTS.

2. Mumbai Tribunal rules on income classification and permanent establishment in respect of e-commerce transactions

eBay International AG vs. ADIT (2012-TII-169-ITAT-Mum-Intl)

Cross Border E-Commerce/Online Commercial Transactions pose various tax challenges. Recently, the Mumbai Tribunal discussed some such aspects in the case of eBay International AG (Assessee), a Swiss tax resident. The Assessee operated India-specific websites providing an online platform for facilitating purchase and sale of goods and services to users based in India. The Assessee had engaged its two Indian affiliates (I Cos) for availing certain support services for which it had entered into a Marketing Support Agreement (MSA). The Assessee earned revenues from the sellers of goods who were required to pay a user fee on every successful sale of their products on the website.

The Tribunal was faced with the following issues:

(i) Whether the user fees received from the sellers in India would be in the nature of fees for technical services (FTS) under the Indian Tax Act (ITA)?

(ii) Whether the Indian Affiliates constitute a Permanent Establishment (PE) of the Assessee under the India-Switzerland DTAA?

The Tribunal ruled that apart from making the Assessee's websites available in India on which various products of third-party sellers are displayed, the Assessee had no role to play in effecting the sales. Accordingly, the fees received from the sellers on the successful sales cannot be designated as consideration for rendering any managerial, technical or consultancy services falling within the scope of FTS definition. The Tribunal, therefore, upheld the classification of the income as "business profits". On the PE aspect under the DTAA, the Tribunal held that while Indian Affiliates are "dependent agents" of the Assessee, as they are legally and economically dependent on the Assessee, they do not result in a PE for the Assessee as they do not have an authority to conclude contracts on behalf of the Assessee. Also, they do not constitute a PE under the "place of management" clause because they perform only market support services for the Assessee; they have no role to play in conducting online business between the sellers and the Assessee or between the buyers and the sellers. Since the Assessee has no PE, business profits earned by the Assessee are not taxable in India.

In view of the importance of the topic, let us discuss the facts and the Tribunal's decision in some detail:

Facts in brief

- The Assessee operated two India-specific websites which provided an online platform to facilitate the purchase and sale of goods and services to users in India.

- The Assessee earns revenue from third party sellers registered on its websites

by charging a "user fee" for facilitating a successful sale between the seller and a registered user. A portion of the revenue is also earned if the sellers intend to list their products more prominently on the websites. The websites are operated from outside India.

- The Assessee raises periodic invoices on the sellers upon successful sales and the payments are collected by the Assessee's Indian group companies viz., eBay India Pvt. Ltd. (I Co1) and eBay Motors (I Co2) – which remit the fee to the Assessee.
- The Assessee entered into an MSA with said Indian Affiliates for availing certain support services in connection with the websites and the Assessee reimbursed the costs incurred by them with an 8% mark-up.
- The Assessee filed a NIL return of income and claimed that since it does not have a PE in India, its income, which was in the nature of business profits, was taxable.
- The Tax Department was of the view that the Assessee's income was in the nature of FTS which was taxable in India.

Tribunal's decision

In a very detailed and well reasoned decision, the tribunal held in favour of the Assessee, as follows:

On characterization of fees received as FTS

The Tribunal held that the consideration received by the Assessee does not fall within the definition of FTS for the following reasons:

- The Assessee becomes entitled to the user fee when there is a successful completion of sale between the buyers and sellers through its websites. The Assessee has no role, much less the provision of any managerial services, in this transaction. The Assessee is also not responsible for any dispute with respect to the sale. The Assessee's websites are analogous to a "market place" where the buyers and sellers assemble to transact. The Assessee only provides a platform for doing business and cannot be regarded as rendering managerial services to the buyer or the seller.
- Neither the buyers nor the sellers are required to avail any technical service from the Assessee to enter into the transaction.
- Because the transactions of purchase and sale of products are routed though the Assessee's websites, which came into existence through necessary technical input, it will not make the users of the websites as availing any technical service; it is a case of use of a "standard facility''.
- Services are said to be technical when special skill or knowledge relating to a technical field is required for the provision of such service. Where, however, technology is used in developing or bringing out any standard facility and the provider of such standard facility receives some consideration in lieu of allowing its use, the users cannot be said to have availed any technical service from the provider by the mere act of using such standard facility.
- There is no point at which the Assessee renders any consultancy, either to the buyer or to the seller, as regards the transaction. It is also not possible for the buyers to consult the Assessee as regards the product to be purchased by them.
- Thus, apart from making the websites available in India on which various products of the sellers are displayed, the Assessee has no role to effect the sales.

Whether Indian Affiliates constitute Assessee's PE in India.

- Under the DTAA, a tax resident of Switzerland can have a DAPE in India if a person, other than an agent of independent status, has and habitually exercises the authority to conclude contracts on behalf of the Swiss resident.
- All the expenses incurred by Indian Affiliates and the nature of their activities as per the MSA point out that the websites are not directly or indirectly controlled by them.
- Though Indian Affiliates advertise in India so as to create awareness of the Assessee's aforesaid websites amongst the sellers to get attracted towards the same, they have no role in directly introducing users to the Assessee.
- The agreements between the Assessee and sellers for the user fee are entered into online through the Assessee's websites directly, without any interference or involvement of Indian Affiliates.
- Thus, the agreements between the sellers and the Assessee and the finalisation of transactions between the sellers and the buyers are done through the websites situated and controlled from abroad.
- The Agency PE rules – Article 5(5) and Article 5(6) – are complimentary to each other. Article 5(5) is considered only if it is proved that an agent is a dependent agent. Consequently, the three conditions specified thereunder need to be satisfied to constitute a PE. Article 5(6) is considered only when the agent is of independent status.
- Indian Affiliates are dependent agents of the Assessee. This is because there is no dispute about the fact that Indian Affiliates are providing exclusive services to the Assessee and their only source of income is from the Assessee in terms of the MSA.
- The first condition under Article 5(5) is not applicable since the provision of marketing services to the Assessee or making the payment collection and forwarding it to the Assessee will not result in Indian Affiliates entering into contracts on behalf of the Assessee.
- The second condition under Article 5(5) is not applicable as there is no requirement for Indian Affiliates to maintain any stock of goods for delivery for or on behalf of the Assessee. The goods are delivered directly by the seller to the buyer in the transaction.
- The third condition under Article 5(5) is not applicable because Indian Affiliates are not required to manufacture or process the goods on behalf of the Assessee. Neither the Assessee nor the Indian Affiliates are involved in the handling of the goods in the transaction.
- Regarding the Tax Department's argument that the Assessee had a "place of management" in India at the place of Indian Affiliate because of which a PE would arise, the Tribunal held that in the absence of a definition of the term "place of management" under the DTAA/ ITA, which in common parlance refers to a place where overall managerial decisions of the enterprise are taken, since all business decisions and deals are settled through the Assessee's websites and Indian Affiliates have no role to play either in the maintenance or the operation of the websites (they only render marketing services and collect the fees for the Assessee), the Indian Affiliates do not constitute a place of business for the Assessee.

The decision in the case of e-Bay International AG being one of very few decisions by the Tribunal in the arena of taxation of E-Commerce, the Reader would be well advised to study this

very detailed and very well argued and reasoned decision for a detailed understanding of the subject.

3. Taxation of income from time charter of ship from operations between Indian ports – Whether taxable as Royalty?

Poompuhar Shipping Corporation Ltd. (PSCL) and *West Asia Maritime Limited (WAML) vs. ITO (2013-TII-37-HC-Mad.-Intl.)*

Taxability of payments made under Time Charter Arrangement (TCA) has been a very contentious issue. Recently, the Madras High Court in the case of Poompuhar Shipping Corporation Ltd. (PSCL) and West Asia Maritime Ltd. (WAML) considered the issue of whether hire charges for chartering shipping vessels (ships) for plying within Indian ports under time-charter arrangement (TCA) and bare-boat charter-cum-demise (BBCD) arrangement, with various foreign shipping companies (FSCs), is taxable in India as "royalty", under the Income- tax Act (ITA) as well as under the applicable DTAA.

While determining taxability under TCA and BBCD, the HC dealt with a number of issues, viz., (a) whether a ship qualifies as equipment, (b) whether charges under TCA and BBCD are for the "use" or "right to use" such equipment and, consequently, taxable as royalty, (c) availability of benefit of Article 8 of the DTAA dealing with shipping income and (d) trigger of permanent establishment (PE) for FSCs by virtue of presence of ships in India.

While ruling in favour of the Tax Department, the Madras High Court held, in a very detailed judgment, that payments under TCA are for the "use" and hire of ships and not for rendition of any service. Further, the ship qualifies as "equipment" for the purposes of "equipment royalty" under the ITA as well as the DTAA and thus, taxable as royalty. FSCs cannot avail the benefit of Article 8 of the DTAA as the ships are not plying in "international traffic" but between two ports in India. Furthermore, operating through FSCs, ships constitute PE and, the income from letting out ships is not effectively connected/attributable to the said PE and could be taxable as royalty on gross basis. The Tax department is permitted to initiate parallel proceedings against the payer (a) as a payer-in-default for failure to withhold tax and (b) as an Agent for assessment of FSCs' taxable income in India as both the proceedings operate in different streams.

Let us discuss the said decision in some more details as under:

Facts in brief

- PSCL, a Government undertaking, was engaged in the business of moving coal from various ports in India to a particular location within India. For this purpose, PSCL entered into TCA with various FSCs for chartering ships. PSCL did not withhold taxes on payments to FSCs as it was of the view that the payment was in the nature of service and was accordingly, not taxable in India under the ITA as well as the DTAA. Further, WAML, a public limited company, was engaged in the business of shipping, had hired a ship from a Cyprus company (Cyprus Co) under BBCD arrangement. WAML claimed that the payments under BBCD were towards option to purchase ship and hence, not taxable.
- The Tax department scrutinised TCA and observed that PSCL was required to pay a fixed sum irrespective of the quantum of freight carried or the number of journeys undertaken by the ships. Accordingly, the Tax department held that the arrangement was not a service but constituted "royalty" as the same was for the "use" or "right to use" industrial, commercial or scientific equipment (equipment royalty). Accordingly, PSCL

was treated as a payer-in-default for not withholding taxes. Additionally, PSCL was also treated as a representative agent (Agent) of FSCs under the ITA.

- In the case of WAML, the Tax department observed that WAML had an option to exercise purchase of the ship at the end of each year, which however, was not exercised. As the ship was deployed on the coastal line between ports in India, benefit of the DTAA was not available.
- Aggrieved, PSCL and WAML appealed before the CIT (Apeals) who upheld the findings of the Tax department and ruled that payment to FSCs was not for rendering services but for hiring ships. As PSCL had control over the captain of the ships and FSCs acted as agents of PSCL, the payment for the ships was for the "use" or "right to use" of equipment and accordingly, taxable as "equipment royalty".
- In the case of WAML, WAML was not the owner of the ship until the last month's hire instalment was paid to Cyprus Co. Thus, till the option to purchase was not exercised, WAML was not to be treated as the owner but only as a hirer of the ship. Thus, the consideration paid periodically was in the nature of hire charges for the use of the ship and not deferred payment of consideration. Accordingly, the payment constituted royalty.
- FSCs (including CyprusCo) cannot rely on Article 8 of the DTAA (shipping income), as the DTAA benefit was restricted only to incomes earned by FSCs from transportation of passengers, goods, etc. in "international traffic". In the present case, the ships are engaged in carrying goods between ports in India and not outside, and the requirement of plying in "international traffic" (between different countries) is not satisfied. The Tribunal upheld the order of CIT(A).

High Court's Decision

The High Court held in favour of the tax department as follows:

TCA - Whether for "Rendering of a Service" or for "Hire of Ships"

i) TCA between FSCs and PSCL provides that (a) PSCL has the liberty to sub-let the vessel for all or any part of the time covered by TCA; (b) PSCL shall pay for the use and hire of the ships for each day, commencing from the date of delivery; (c) the usual places of loading shall be at PSCL's disposal; (d) the place of re-delivery of ships is at PSCL's option; (e) the masters/captains and others working in the ships are at the disposal of PSCL; and (f) PSCL is to provide for all operating expenses such as fuel, port charges, pilotages, agencies, commissions, consular charges, etc.

ii) The Supreme Court (SC) in Gosalia Shipping P. Ltd. (113 ITR 307) considered similar clauses in TCA and ruled that the payment by hirers was not on account of carriage of service, but was payable on account of use and hire of ships. The SC, thus, ruled that a TCA is essentially for the use and hire of ships and the amount payable to FSCs is irrespective of what use the ship is put to, by the hirers. Accordingly, payments under TCA are for the "use" and hire of ships and not for rendition of any service.

Whether payments constitute royalty

iii) Under the ITA as well as the DTAA, "royalty" means the consideration paid for the "use" or the "right to use". Consideration paid for use or right to use "simpliciter" is sufficient for characterisation as "royalty".

iv) The SC in Rashtriya Ispat Nigam Ltd. (77 STC 182) observed that by giving possession to the hirer who has control

and custody, the condition of "use or right to use" is satisfied. Thus, so long as the hirer is given the right to use (with a right to put the equipment to beneficial use for itself, or to keep it idle, or the right to sublet) and accesses the ships to its advantage economically then, the requirement of "use or right to use" is met.

v) The term "use" or "right to use" is intended to take its ordinary meaning and needs to be applied in the broader sense, i.e., "employing for any purpose". Thus, presence or absence of possession, effective or general control, and custody with the payer may not be relevant while evaluating the character of a payment.

vi) PSCL, as per TCA, had right to use ship, select the time and decide route as per its requirement. Though PSCL did not have physical possession of the ship, the payment is for the use or right to use the ship. Accordingly, where PSCL derives an economic benefit from the ships, consideration paid thereof constitutes "royalty". In the case of WAML, under BBCD, WAML was not the owner of the ship and the consideration was, therefore, in the nature of hire charges for the use of the ship.

Whether ship is equipment :

vii) The term "equipment" has not been defined under the ITA or the DTAA. However, the term "plant" has been defined in the ITA for depreciation purposes while computing income under the head "Business or profession", in an inclusive manner. This inclusive definition embraces within its fold a ship, book, medical equipment, apparatus, etc.

viii) The term "plant" is judicially understood as an apparatus used by a businessman for carrying on his business, including goods and chattels (movable or immovable), which is meant for permanent employment in such business. Thus, plant includes every tool, apparatus, equipment or machinery, not limited to machinery used in tool.

ix) The word "equipment", when construed in light of the equipment royalty clause, extends the normal or ordinary meaning of the word. Also, the equipment royalty clause uses the term "any" before the term "equipment". This clearly points out the need for construing the said term widely, so as to embrace every article employed by the taxpayer for the purposes of its business. So long as the equipment is employed for the purposes of one's income, they shall also fall within the ambit of "equipment royalty", even if it is referred to as an apparatus or plant or machinery. Thus, a ship is an "equipment" of the business of a ship owner on a natural and ordinary meaning of the word.

x) Therefore, a ship, being a plant, with which FSCs operate their business, and commercially exploit for earning income, qualifies as an "equipment" and accordingly, user charges thereof are taxable as "equipment royalty" under the ITA.

Applicability of Article 8 of DTAA

xi) Under Article 8 of the DTAA, payment to FSCs which are operating only in "international traffic" is taxable in the country in which FSCs have a "place of effective management". In the present case, FSCs (including CyprusCo) had let out the ship for use for plying within Indian coastal waters. As the ship operated between the coastal lines of two ports in India and thus, the test of "international traffic" is not met. Accordingly, the payer could not invoke Article 8 for determining

taxability of payments to FSC for the purposes of tax withholding.

Ship as "PE" in India

xii) As per Article 5 of the DTAA, a PE is a fixed place of business through which the business of FSC, i.e., the FSC based out of Cyprus, is wholly or partly carried on in India.

xiii) FSC is the owner of the ship which is let out on hire to WAML. The ship is designated as a coastal vessel, i.e., which is exclusively employed for plying between ports in India. The ship is used continuously, in excess of 90 days, in India. The hiring of the ship is not occasional but for a continuous period.

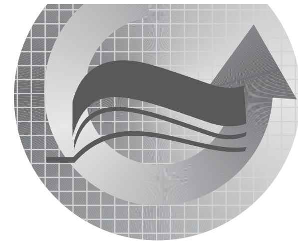
xiv) In order for a PE to exist, there must be a fixed place for the business to be carried on. In the case of equipment, a fixed place can be found to exist even though the equipment, for a single customer under one integrated contract, may be relocated from one place to another. A movable place of business is thus, treated as fixed when most of the equipment is used at fixed points within a proximate area on a repetitive continuous basis for sufficient period of time as required by the business. Thus, when the business activities are peripatetic and the equipment moves between neighbouring locations, a single place of business exists, which presents a coherence in commercial and geographical aspect with regard to the conduct of business.

xv) The moving ship has a place of business where the ship is docked and the fact that the ship moved from one point to another is the result of the nature of business contract and such movement is an integrated one having business and geographical coherence. This leads to an inference that FSC has a PE in India. However, the receipt of hire charges is not attributed as the income earned from the PE but, for the use or right to use the ship and consequently, is taxable as "royalty" and not as business profits since the income is not effectively connected/ attributed to the said PE

It may be noted that this decision would not apply to cases where TCA is in respect of ships plying in international traffic. Since the ships, in the present case, were plying along the Indian coastal line and not in international traffic, the benefit of the shipping article of the DTAA was not available to the assessees.

Conclusion

Lately India has become a major source of jurisprudence in the field of International Taxation and Transfer Pricing (much more than its share in the World Trade and Investment). India is being perceived as an uncertain and very tough and aggressive tax jurisdiction. With constant change in the Taxation Rules (sometimes with Retrospective effect) and Procedures and a wide variety of bewildering and often contradictory decisions, even Senior Counsels are at times at their wits end while advising the Tax Payers and their CFOs and advisors. In view of very huge demands raised by the Tax Administration on certain Foreign Investors, sometimes running into billions of dollars, it has become a daunting task to invest in India. Time has come for all of us to put our heads together to simplify the tax rules and make India an attractive tax jurisdiction for Foreign Investors.



CA C.A. Gupta & Samir Parekh

Taxation of Expatriates

Overview/Background

India has evidenced a huge influx of foreign investment after the liberalisation of it's economy in 1991. The liberalisation has earned it the recognition of one of Asia's most favoured investment destination during the last 2 decades. Further, India also witnessed a significant growth in its software industry during the said period and has been the leading destination for outsourcing of operations.

This liberalisation and development also resulted in significant movement of specialised individuals/personnel to and fro from India. [Individuals whose role in the organisation varied (such as nurturing the investments, guiding the employees, sharing their knowledge/expertise, supervision of projects, managing the organisation, etc.)]

Obviously, the tax implication of such movement is therefore an important area of concern for the individual as well as the organisation that would need to be understood of so as to ensure timely compliance with the relevant laws (of the country) as well as ensure that all the cost relating to such movements are properly factored.

In the below discussion, hereinafter, the said individual is referred to as "Expatriate" ("Expatriates" for plural) for ease of reference.

So, let us begin with understanding on what it holds for the expatriate.

Impact on Expatriate

Taxability – as per ITA

The Income-tax Act, 1961 ("ITA") recognises residence based taxation as well as source based taxation in case of individual taxpayers[1].

As residence is a key criteria for determining the scope of taxable income of an Expatriate, the first and foremost step would be to determine the residential status of the Expatriate.

An individual taxpayer in India could qualify as either of the following during a relevant assessment year[2]:

a) Resident and Ordinary Resident in India ("ROR")

b) Resident but Not Ordinary Resident in India ("RNOR")

c) Non-Resident ("NR")

1 Section 5 r.w.s. 9 of ITA

2 Section 6 of ITA

The residential status of an Expatriate would be determined based on the number of days, he would be present in India during the relevant assessment year as well as in certain preceding years. This presence refers to actual physical presence and therefore, it is imperative for an Expatriate to track his movement effectively.

Once the residential status is determined, the scope of taxable income would be determined as per the provisions of section 5 and section 9 of the ITA.

A ROR status would trigger India tax on entire income (including income accruing outside India). In respect of RNOR or NR, the key question would be whether the income received falls in any of the below categories:

(a) Income received or deemed to be received in India

(b) Income accruing or arising or deemed to accrue or arise in India

At this juncture, it will be important to refer to the provision of section 9 of the ITA which deems income to accrue or arise in India. Under section 9(1)(ii) of the ITA, income which falls under the head "Salary" if it is earned in India shall be deemed to accrue or arise in India.

An Explanation was inserted in section 9(1)(ii) by the Finance Act, 1983 (w.r.e. from 1st April 1979) to clarify that income payable for services rendered in India shall be regarded as earned in India. This amendment was to overcome the decision of Gujarat High Court in the case of P. G. Pgnatale (124 ITR 391). The salary received by an Expatriate for services rendered in India is therefore taxable in India irrespective of whether the salary is received in India or not.

The Explanation was further amended by the Finance Act, 1999 with effect from 1st April, 2000 to provide that the rest period or leave period which is preceded and succeeded by services referred in India and forms part of the services contract of employment shall be regarded as income earned in India.

Accordingly, in view of the aforesaid provision, an expatriate qualifying as a RNOR/NR should be taxable in India on the salary received for services rendered in India. Further, the leave period would also qualify as period during which services were rendered in India if the said leave preceds and succeeds the work day in India.

It is however submitted that in certain situation the salary received for services rendered may not be taxable in India. Under section 10(6)(vi) of the Act, the satisfaction of the following conditions can result in the Expatriate being not subject to tax in India in relation to salary earned for services rendered in India:

(a) The individual taxpayer is not a citizen of India;

(b) The remuneration is received by him as an employee of a foreign enterprise for services rendered by him during his stay in India;

(c) The foreign enterprise is not engaged in any trade or business in India;

(d) The stay in India during the relevant assessment year does not exceed in aggregrate a period of 90 days; and

(e) The remuneration paid to the individual is not liable to be deducted from the income of the employer chargeable under the Act.

There are other provisions as well under the ITA [such as section 10(8), section 10(8B), etc. of the ITA] which provides for exemption from taxation (not discussed in detail).

Taxability as per DTAA

Section 90 of the ITA permits a tax-payer to be governed by the provisions of the Double Taxation Avoidance Agreement ("DTAA") entered into by India to the extent the said provisions are beneficial to the taxpayer. The provisions of the relevant DTAA would apply to an expatriate, if he qualifies as a tax resident

of either of the country or in any one of the country.

The examination of the provisions of the DTAA therefore plays a key role in the determination of the taxability of an Expatriate. The important provisions to be examined in this regard are the Article on Residence and Dependent Personal Service/Income from Employment.

The Organisation of Economic Co-operation and Development ("OECD") has been a pioneer in monitoring international trade related issues. It has developed a Model Tax Convention on Income Tax and Capital ("OECD Model") to guide the countries seeking to entry into tax treaties. There is also a similar Model developed by United Nations which is also referred to by India for the purpose of its tax treaties. While India is not a Member of OECD, for our discussion, we have reproduced below the relevant text of the said Model as the Article useful for our reference are similar worded in most of the tax treaties entered by India.

Article 15 of the OECD Model deals with Income from Employment. The text relevant in this context is reproduced in the Annexure:

Paragraph 1 of the said Article provides a right of taxation to the country in which the employment is exercised. However, as per paragraph 2, the said right may not be exercisable if the conditions as mentioned therein are satisfied. The said conditions are normally referred to as conditions for "short stay exemption" under the DTAA.

The following table enumerates the key characteristics of the short stay exemptions under the ITA as well as under the DTAA:

Under ITA	As per Article 15 of OECD Model
Applicable in case of individual who is not a citizen of India	Applicable to resident of the Other Contracting State with which India has a DTAA
Stay in India does not exceed in aggregate a period of 90 days during a relevant assessment year	Stay in India does not exceed 183 days in aggregate in any twelve month period
Remuneration is not liable to be deducted from income of the employer chargeable under ITA	Remuneration is not borne by a Permanent Establishment of the employer in India
Remuneration received by him as employee of foreign enterprise	Remuneration is paid on or behalf of employer who is not the resident of India
Foreign enterprise not engaged in any trade or business in India	

Accordingly, an Expatriate is taxable in India unless he is eligible to claim benefit of short stay exemptions either under ITA or DTAA.

In order to ensure that the employee is not adversely impacted by the assignment, one of the recognised practices among employers globally is to safeguard the employee's interest in such a manner that he is neither worse off nor better off by virtue of his movement to a different country. This is achieved by including in the International Assignment Policy as well as in the assignment letter of the employee, clauses in relation to **Tax Equalisation**.

Broadly speaking, Tax Equalisation is a concept whereby the employee would be entitled to receive the same net take home salary that he may have been received if he continued to render services in his home country. Any increase or reduction in such liability would be taken over by the employer.

The terms of the Tax Equialisation may vary from company to company.

However, the Tax Equilisation provision may not in all case deal with tax on income other than salary. The Expatriate may be subject to tax on such income, particularly when he would be qualifying as ROR. The tax liability in India in such case may need to be analysed after due examination of the provisions of applicable DTAA.

Impact on employer

A. Tax Deduction at Source

Section 192 of the ITA requires any person responsible for paying any income chargeable under the head "Salaries" to deduct tax at source ("TDS"). The ITA therefore obligates an employer to deduct tax on the taxable salary payable to the Expatriates and comply with the related compliances.

Section 195A of the ITA requires the deductor to increase the amount on which tax is required to be deducted to an amount which after deduction will be equal to the net amount payable to the deductee, if the tax on such amount is to be borne by the deductor. Accordingly, it is important for the employer to apply the said provisions where under the engagement terms, the employer entity is required to bear the tax.

The employer would further also require to bear in mind the procedural provisions under the Act in particular the following for computing the tax liability to be deducted at source in relation to Expatriate:

(a) Section 10(10CC) of ITA

(b) Rule 26 of the Income Tax Rules – for conversion of salary.

Issues – Expatriate taxation

Some of the key issues faced in connection with determination of taxable salary of an Expatriate which have been considered by various courts / authorities are discussed as under:

Liability to deduct tax – Concept of economic employer

The issue which sometime arises in the case of an Expatriate deputed to India is the entity which has to comply with the withholding tax obligation i.e. the entity to which the employee is assigned or the entity which is its legal employer.

While in law such obligation is generally believed to be complied by the legal employer, from an Indian perspective, it would be important to refer of the decision of the Supreme Court in the case of Eli Lily & Co. (India) (P.) Ltd. (312 ITR 225).

On a debate in relation to which entity is required to deduct tax was raised, the Hon'ble Supreme Court in the said case held that the Indian entity was required to deduct tax as no work was found to be performed for the foreign company and entire remuneration paid was only for services rendered in India. The said decision is the foremost ruling which seems to recognise the concept of an economic employer in the domestic tax law context.

Deduction for hypothetical tax

Under the "Tax Equalisation" policy, the Expatriate is effectively entitled to receive only the net salary from the employer. This is however practically monitored in the payroll through a reduction towards hypothetical tax i.e. the tax to be borne by employee if he was not on deputation.

The issue of whether the said deduction is an actual reduction and therefore not allowable has been an issue of contention with the income tax authorities. However, the issue now appears to have reached a reasonable conclusion in view of the following decisions wherein the Courts have held that only the net salary received from the employer is taxable in the hands of the employee:

1. Yoshio Kubo and Others (357 ITR 452) [Delhi High Court]
2. Jaidev Raja (211 Taxmann 188) [Bombay High Court]
3. Roy Marshall (ITA No. 2038/Mum/06) [Mumbai ITAT]

Deduction for mandatory contributions

In certain countries, for example – France, the residents are obligated to contribute to mandatory social security schemes irrespective of whether they are in employment or not. The deduction of said payment in the hands of an Expatriate being in the nature of diversion of income by overriding title has been a debate with the tax authorities.

The said issue was examined in the decision of the Income Tax Appellate Tribunal ("ITAT"), Mumbai in the case of *Gallotti Raoul vs. ACIT (61 ITD 453).* On a perusal of the facts of the case, the Hon'ble ITAT held that the contribution towards mandatory schemes are to be treated as diversion of income by overriding title and the portion of salary represented by said contribution never accrued to the expatriate.

Tax implications of stock options

Section 17(2)(vi) of the ITA defines perquisite to include the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer free of cost or at a concessional rate. The value referred is the fair market value of the specified security or seat equity shares on the date on which the option is exercised as reduced by amount actually recovered from the employee.

In case of an Expatriate, there could a scenario that he/she has rendered services only during a part of the period between the grant date (i.e. date on which Stock Option is awarded) and vest date (i.e., date on which the right to exercise the option vested on the employee) / exercise date (i.e., date on which the option is exercised).

An issue arises as to whether the entire benefit derived by the employee under the Stock Option is taxable in India.

There is no specific guidelines/clarifications provided in this regard under the ITA.

The said issue has been dealt with in a recent decision of the Hon'ble Delhi ITAT in the case of *ACIT vs. Robert Arthur Keitz* wherein on the examination of the facts the ITAT has held that only the proportionate amount of stock option benefit relating to the period of services rendered in India during the grant period should be taxable in India.

The aforesaid decision should be helpful in resolving the challenges in this regard.

Taxability on receipt

An another interesting issue was raised before the Bengaluru ITAT in case of Bholanath Pal (52 SOT 369).

The assessee in the said case was receiving salary in India for services rendered outside India. The assessee contended that the provisions of section 5 read with section 15 of the ITA provides that the tax implication on receipt basis as per section 5 of the ITA only applies to arrears of advance salary. Accordingly, as the salary received in India for services rendered outside India cannot be deemed to accrue or arise in India, the assessee should not be subject to tax in India merely on receipt basis.

The Hon'ble Bengaluru ITAT appears to have accepted the said contention of the assessee.

The aforesaid ruling opens up a new debate, in particular for Expatriate on deputation outside India.

Short stay exemption – Taxation on presumptive basis

One of the key considerations for eligibility to claim short stay exemption under the DTAA is that the remuneration paid should not be borne by a Permanent Establishment or deductible in

computing profit or deductible in determining taxable profits (as may be provided in the relevant DTAA).

In this connection, there has been a contention by the tax authorities that if the employer is subject to tax on presumptive basis as per the provisions of the ITA read with DTAA, then the deduction is deemed to have been claimed and therefore the Expatriate is not eligible for short stay exemption.

In this context, it will be important to refer to the following decisions wherein the terms borne by/deductible have been analysed and it has been held that in case of presumptive taxation it is deemed that the deduction has been claimed:

1. *Lloyd Helicopter International Pty Limited (249 ITR 162) [Authority for Advance Ruling ("AAR")]*
2. *Pride Foramer S.A. (97 ITD 86) [Delhi ITAT]*
3. *Ensco Maritime Ltd. vs. DCIT (91 ITD 459) [Delhi ITAT]*
4. *DHV Consultants (147 Taxmann 521) [AAR]*

It is understandable that for the purpose of application of presumptive taxation, the deduction is deemed to have been claimed. However, an interesting question is whether it can be considered that deduction has been claimed by employer merely on the basis that the income of employer is taxed on presumptive basis.

Tax borne by employer – Whether monetary perquisite

Section 10(10CC) of the Act provides that tax on non-monetary perquisite borne by the employer at his option would be exempt in the hands of the employee. The employer in such case is not entitled to claim deduction of said tax paid against its income as per section 40(a)(v) of ITA .

In this connection, a contention was raised by the employer – assessee that the tax so borne by the employer is a non-monetary perquisite and accordingly, the employer is not required to gross up the tax liability so borne by the employer.

The issue first came up before the Special Bench of the Delhi ITAT in case of *RBF Rig Corporation vs. Asst. CIT [18 SOT 466].* The same was also raised before the Uttarakhand High Court in the case of *Sedco Forex International Drilling Inc. (252 CTR 448).* The Hon'ble High Court and the Special Bench has upheld the contention of the employer – assessee and affirmed that tax borne by the employer would construe as a non-monetary benefit. The impact in simple terms is explained as under:

Particulars	Employer-assessee contention	Department's contention
Taxable salary	100.00	100.00
Add: Gross up u/s. 195A	30.90	44.72
Total taxable salary	**130.90**	**144.72**
Less: Tax liability @ 30.90%	40.45	44.72
Net salary	90.45	100.00

In view of the said decisions, the employer-assessee should be eligible to reduce it overall cost burden [provided the tax paid is not disallowable in the hands of the employer-assessee as per the provisions of section 40(a)(v) of ITA].

The aforesaid are few of the key issues faced in determining the taxable salary of Expatriate for services rendered in India. This emphasises the utmost caution with which the taxability of Expatriate needs to be approached.

B. Whether reimbursement received for salary taxable in India

As indicated above, the purpose of the visit to India of an Expatriate can be varied. The services

of an Expatriate may have been requested by an Indian entity in the group for the furtherance of its own business objective.

In such cases, many often, the overseas entity deputing its employees to its group company in India would like to recover the cost of such deputation for a number of reasons.

In this context, the taxability of such recharge has also been the subject matter of great debate. In the following case such recharge of salary has been held to be in the nature of reimbursement of salary and therefore not taxable in India.

1. *IDS Software Solutions (India) (P.) Ltd vs. ITO (32 SOT 25) (Bang. ITAT)*
2. *Cholamandalam MS General Insurance Co. Ltd. (309 ITR 356) (AAR)*
3. *Ariba Technologies (India) Pvt. Ltd. (ITA No. 616/2011) (Bang. ITAT)*
4. *Temasek Holdings Advisors (I) P. Ltd. vs. DCIT [2013] 38 taxmann.com 80 (Mum Trib)*

In certain other cases such reimbursement has been held to be in the nature for fees for technical services and therefore liable to tax in India.

1. Target Corpn India (P.) Ltd., In re (24 taxmann.com 152) (AAR)
2. AT & S India Private Limited, In re. (287 ITR 421) (AAR)
3. Verizon Data Services India (P.) Ltd., In re (337 ITR 192) (AAR)
4. Centrica India Offshore Pvt. Ltd. [2012] (249 CTR 11) (AAR)

As highlighted in the aforesaid rulings, the fact whether such recharge is in the nature of reimbursement or a charge for the services would depend upon the number of factors including the following:

a) The nature of agreement between the different entities
b) Whether the individual works under the control and supervision of the company where he is deputed,
c) The right to terminate the contract, etc.

C. Whether the presence of employee trigger a Permanent Establishment in India

The provisions of ITA are wide enough to bring into the tax net any income derived from any business connection with India[3]. The provisions of the DTAA constrain the said impact by requiring a presence in the form of Permanent Establishment ("PE") in India to trigger India tax incidence.

The presence of the employees in India could nonetheless result in the creation of PE of the deputing entity in India. The immediate risk is the triggering of the Service PE which in certain scenarios can arise even with the rendition of services of one day to Associated Enterprise (as defined under the DTAA).

Illustratively, under the DTAA between India and United States, PE could be arisen on furnishing of services, other than included services as defined in Article 12 (Royalties and Fees for Included Services), within a Contracting State by an enterprise through employees or other personnel, but only if:

(i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period ; or

(ii) the services are performed within that State for a related enterprise [within the meaning of paragraph 1 of Article 9 (Associated Enterprises)].

Accordingly, if the services rendered by the Expatriate do not qualify as fees for included

3 Section 9 of ITA

services as defined in Article 12 of India – USA DTAA, then rendition of one day of services to a related enterprise could trigger a PE (i.e., Service PE).

The DTAA entered by India with Australia, Canada, China, Singapore and United Kingdom also contains the provisions of Service PE.

A continuous presence could also result in a Fixed Place PE.

Where the PE is triggered, the employer would be subject to tax in India in relation to profit attributable to the services rendered by such employees in India.

The aforesaid may have significant ramifications on the employer.

D. Transfer Pricing

In the event of any charge to the Indian entity by way of fee, the employer may require to comply with the Transfer Pricing provisions

The implication from an indirect tax perspective may also be needed to be evaluated.

Summary

To summarised, the taxation of Expatriate has multi-fold implications in relation to taxability on the Expatriate as well as the employer. Some of the issues have reached to a stage of achieving a settled position, while few of the issues are still open ended subject to interpretation. In order to avoid any hick ups, it would therefore be advisable to duly analyse the implications at the time of commencement of assignment.

Annexure

Article 15 – Income from Employment (as per OECD Model)

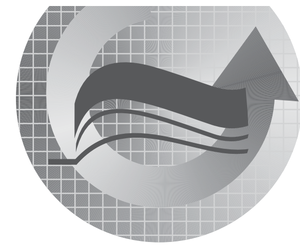
1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

   a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and

   b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and

   c) the remuneration is not borne by a permanent establishment which the employer has in the other State.



CA Rashmin Sanghvi

PE with reference to e-Commerce

1. Issue

We understand what is PE & what is e-Commerce. Concept of PE has worked reasonably well in traditional commerce for several decades. What is the special problem in case of e-commerce? If there is a problem, what is the solution?

2. Summary

Concept of PE is dependent on physical presence of the Non-Resident assessee in the Country of Source – COS (which is also referred to as "Host Country"). Modern instruments (like internet, computers, telecommunication, television and mobile phones) facilitate doing global business without physical/personal presence in the COS. They don't need a PE in the Country of their Revenue. In fact for e-commerce companies, even the Country of Residence – COR can become irrelevant. Hence e-commerce companies can avoid COS & COR taxes. Companies like Google Corporation – with annual revenues in billions of dollars are alleged to have avoided Indian & British income-tax. This is done within the existing legal frame work for International Taxation.

Government of India, G20 and OECD have realised the significant revenue losses due to an outdated system of international taxation. OECD is trying to develop an alternative system of international taxation where such revenue losses can be curbed.

Government of India has already amended the law to curb tax avoidance. However, it is not a complete solution.

This entire issue has been discussed in details in our article: "Taxation of a Global Corporation – e-Commerce" – which has been published by The Chamber of Tax Consultants in: "International Taxation – A Compendium" Volume IV, Article No. 133 on pages 443 to 520. That article is conceptually "heavy" – difficult to grasp. Also, quite lengthy. Hence not many have read it. In this short article the issue (stated in the first paragraph above) is dealt with briefly and in an easier language. For a researcher, the article in the Compendium is the complete article.

3. PE – Permanent Establishment: (Article 5 in OECD Model)

This concept was developed when computer, internet, television, mobile phones etc. were not available. In those times, it was necessary for a businessman, who wanted to do business outside his COR, to set up a branch/sales office/factory, etc. in the COS. Alternatively, in case of technical consultants or agency business – which do not require a permanent establishment in the

COS; personal visits were necessary. Draftsmen draft the law considering the circumstances prevalent and known to them at the time of drafting. Hence this concept was so drafted that in the absence of physical/ personal presence, there is no PE.

4. Business Income: (Article 7)

Currently all models of Double Tax Avoidance Agreements have so drafted the Article 7 that – normally the business income is taxable only in the COR. However, if the assessee has a PE in the other country – COS, then he can be taxed in the COS. Thus the PE is a threshold of Non-Resident's presence in COS. If the presence is beyond the threshold, his income is taxable in COS. In absence of the presence in the form of PE, the Non-Residents' income is not taxable in COS. The issue is, today substantial business is done by small and big companies without requiring any PE outside their COR. Hence their incomes go tax free.

5. Consider an illustration

Google Corporation is an entirely e-Commerce company. It provides access to information available on numerous websites all over the world. When people use Google's communication service, they are also shown advertisements. Google's revenue model depends upon advertisement. This is something like TV/newspaper media. Viewers pay little if at all. Companies run on advertisement revenue.

Google provides the communication service on internet. It need not meet and need not even know the viewers as well as the databases. It has its viewers, databases and advertises all over the globe. It has no PE outside its COR. It pays almost no tax to the countries from which it earns its revenue.

Its global headquarters is in USA. Media reports suggest that proper taxes are paid to the US IRS. A group of subsidiaries operate from tax havens – Ireland and Bahamas. All revenue outside USA is received by an Irish Company. By an elaborate structuring and tax avoidance scheme Google avoids substantial taxes. The planning is claimed to be legal on the following grounds:

Google has no PE outside USA & Ireland. Its revenue from India, Britain & other countries does not amount to Royalty or Fees for Technical Services (FTS). Ireland has signed Double Tax Avoidance Agreements (DTA) with many countries. So Google gets the DTA protection. Hence it need not legally pay any taxes in the country from which it receives revenue. Within Ireland, the taxes are minimised by utilising friendly tax systems in Ireland and Bahamas.

Now the issue before the G20 & OECD is: Google's tax avoidance scheme is legal. But not acceptable. If something is legal & yet not acceptable, it is clear that the law has to be changed. What should be the changes in the DTA models & in domestic laws?

Note: Google's case is discussed here only as an illustration. There are many other companies that avoid taxes by utilising the gaps in the existing system of International taxation. I am relying on media reports for stating the tax avoidance scheme. I have no direct knowledge. One may assume that Google is not avoiding any taxes. The issue is e-Commerce companies can avoid taxes in this manner. How would Governments prevent such tax avoidance?

6. Indian attempt to solve the problem

Let us see the solution attempted by Central Board of Direct Taxes (CBDT), India. Section 9 of the Income-tax Act has been amended. Please see the explanation at the end of section 9, after section 9 (2).

> *"Explanation – For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be*

deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and shall be included in the total income of the non-resident, whether or not –

(i) the non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India.

To elaborate the impact of this explanation, let us consider a few issues. Google provides its services from Ireland. It has no PE and no residence in India. Hence in absence of this explanation, Google's revenue from India cannot be taxed under The Indian Income-tax Act. However, Google's services are utilised in India.

At the first thought, it seems that this explanation attempts to make it possible to tax Google on the basis of services utilised in India. This first thought would be incomplete.

Clauses (v), (vi) & (vii) of section 9(1) provide that interest, royalty & FTS paid by Government of India, or by an Indian resident, etc. shall be taxable in India. This adds a new dimension. "Where the services are utilised" becomes irrelevant.

A payment becomes taxable in India when payment is made by Indian Government or Indian resident; for a business conducted from India. The services or interest may be utilised anywhere in the world.

Even if the payment is made by a non-resident (for services utilised in or outside India); it may be still taxable if utilised for a business conducted from India.

This issue can be further elaborated. However, such elaboration is beyond the scope of this article. In simple words, if any payment to a non-resident is claimed as a deductible expenditure by a business or profession taxable in India; such payment will be included within the "Scope of Total Income" under section 9. It is also called the "Base Erosion" approach: "If my tax base is eroded due to a payment, I will tax the payment."

Let us see whether this attempt is successful or not.

7. This explanation [after S. 9(2)] applies only to clauses (v), (vi) & (vii) of section 9 (1). In other words, this explanation applies only to interest, royalty and FTS. Google would claim that it has a business income. Hence this explanation will not apply to Google's revenue. Hence even after the amendment to section 9, Google's revenue will remain tax free.

8. India has a DTA with Ireland. Because of the DTA protection, the concept of business connection would not apply to Google. And Google has no PE in India. The amendment in section 9 does not override the Treaty. This amendment has not been included in section 90(2A). Hence even in the case of interest, royalty & FTS; if the assessee is a resident of a country with which India has signed a DTA, the explanation will not apply. In other words, this explanation does not override the treaty. Hence the income will not be taxable.

Conclusion so far: With all the amendments, Google's business income from India remains free from Indian Income-tax.

9. Home consumption

In normal discussions, we do not consider television as E-Commerce. However, whether the television programme broadcaster uses internet or television satellites – it makes no difference for taxation. We may consider all businesses that can be conducted without PE as "Distance Business" and treat all such businesses equally.

Television companies earn billions of rupees revenue. Some of it is from cable service providers or from DTH (Direct to Home) services. Home users shall not claim their payments as deductible expenditure. Yet these revenues must be taxable.

Hence, in addition to the "Base erosion" concept, even Home Consumption payments may be taxed.

Instead of a physical threshold, Government may provide a financial threshold. For example, any non-resident provider of goods & services, who gets a revenue of ` 10,00,000 or more in a financial year, shall be liable to tax in India. To achieve this objective, the definition of PE may be expanded to include a financial threshold of say, ` 10,00,000.

10. Solution

10.1 All the treaty models need to be radically modified. The existing concept of PE & residential status will be applicable to assessees doing business in the traditional manner. However, there will be an additional sub-clause in Article 5 – sub-clause No. 5.8. This sub-clause will provide for a financial threshold of ` 10,00,000. It will be applicable to all non-residents who get revenue from India without having a PE in India under Articles 5.1 to 5.7. Treaty will provide for rates of TDS on the goods and services for which payments are made from India exceeding a threshold amount of ` 10,00,000. The TDS will be applicable irrespective of the category of the income. It will be applicable to goods & services sold – for business or home consumption. The assessee will be free to file return and claim lower or nil tax liability.

Treaty will provide for rates of TDS. The tax jurisdiction has to be acquired under the Indian Income-tax Act. Necessary amendments may be made in section 9.

10.2 OECD and UN will take a long time before the modified models come into effect. India cannot wait for a long time. The CBDT may make amendments in the Indian Income-tax Act. The amendments will be similar to what is suggested as amendments in the Model Conventions – paragraph 10.1 above. These amendments in the Act should override the treaties. They should be included in section 90 (2A) and section 90A(2A).

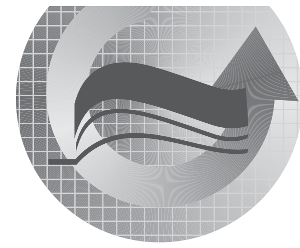
The consequence of this amendment will be that the Act will override the treaty. And all assessees earning revenue from India under any kind of PE – Physical or financial – will be liable to tax in India.

I understand that there will be several issues and objections on the above suggestion. Some of the issues are discussed in detail in the paper published in Chamber's Compendium. This being a short article, I end my submissions here.

The 'I' in illness is isolation, and the crucial letters in wellness are 'we'.

Health is the greatest possession. Contentment is the greatest treasure. Confidence is the greatest friend.

— Lao Tzu



CA Sudhir Nayak

Income arising out of International Transactions – Charging Provisions, MAP and Article 9

In view of the present day world trade not being confined to within state but encompassing more than one country, international tax becomes relevant while planning the transactions. Even the OECD report on Base Erosion and Profit Shifting (BEPS) have acknowledged that in international tax, transfer pricing would become relevant for transaction among the group companies spread across various jurisdictions.

A. International transactions –Charging provisions

In the Indian context also we have witnessed Transfer Pricing Regulations ('TPR') as the most persistent cause for headaches suffered by multinational companies in the past decade. While transfer pricing adjustments are generally driven based on the facts, business operations, comparables, identification of the most appropriate method, etc, it is the litigation surrounding the legal interpretation of transfer pricing provisions which have the most wide reaching ramifications for the taxpayer community as a whole. This article relates to whether the TRP can be construed as charging provisions which operate independent of section 4 and section 5 of the Income-tax Act, 19961 ('Act').

The key provisions of the TPR are sections 92, 92A and 92B of the Act. Section 92(1) of the Act requires that income arising out of international transaction shall be computed having regard to the arm's length price ('ALP'). The aspect which comes to mind on a plain reading of the section is that there should be an income which arises to a taxpayer. The follow up questions to such interpretation are whether (i) whether it is necessary that there should be some income for invoking TPR; (ii) whether TPR can be invoked even if the income is not liable to tax in India on account of the provisions of the tax treaty; and (iii) whether the international transactions can be re-characterised by invoking TPR.

One of the controversies which have been doing the rounds of the Indian tax courts is in the context of share issue by Indian companies. In the recent case of Shell India, the Indian revenue authorities ('IRA') ruled that the difference between the ALP and the actual issue price of share issue should be characterised as debt given by the issuing company to the share applicant, and thus the issuing company ought to have earned interest on the same. This is a strange case of a situation where the company receiving the funds is deemed to have advanced loan to the company which has in reality paid the funds. Further, more importantly, under the normal provisions of the Act (keeping TPR aside), the receipt of funds for issue of shares does not give rise to any income for the share issuing company (unless the provisions of unexplained credits under the Act are raised) and no income is received/accrued to the share applicant (unless

recently introduced provisions of section 56(2)(viib) are raised). In such a scenario, invoking TPR seems unfair. Similar controversy has arisen in the case of Vodafone, where the writ petition has recently been rejected by the Bombay High Court albeit with some encouraging remarks/ directions.

Further, in the past, the question of applicability of TPR in the context of 'group restructuring' has also been raised. In the case of Vanenburg Group BV[1], the Authority for Advance Rulings ('AAR') ruled that the transfer of shares of an Indian company pursuant to a group restructuring was not taxable in India as per the provisions of the applicable tax treaty. Consequently, the AAR held that TPR are machinery provisions which would not apply in the absence of liability to pay tax. Further, In Dana Corporation[2], it was stated that the expression "income arising postulates that the income has arisen under the substantive charging provisions of the Act. In other words, the income referred to in section 92 is nothing but income captured by one or the other charging provisions of the Act. Likewise the rulings of Praxair Pacific Limited[3], GoodyearTire and Rubber Company[4] and Amiantit International Holding Ltd[5] held that TPR cannot bring to charge any income to tax, which was otherwise not chargeable under the Act. Further, the TPR are machinery provisions, which would not apply in the absence of any income. One wonders whether a similar rationale should not equally apply to a transaction of share issue for the reasons discussed above.

It is unfortunate that, despite its earlier rulings, the AAR itself had reignited this controversy by departing from its earlier stand and ruling that TPR can apply irrespective of whether income is taxable in India or not. The key rulings in this regard were Castleton Investment Limited[6] and Armstrong World Industries Mauritius[7]. In the said rulings, the AAR held that the benefit of the tax treaty is invoked by a non-resident taxpayer after calculating the capital gains under the normal provisions of the ITA and the TPR can be invoked at the time of such capital gains computation under the Act. The question which comes to mind is whether the tax treaty benefits for capital gains tax exemption in India would apply to the entire capital gains, including any adjustments under the TPR and if yes, then whether the adjustments under TPR become irrelevant?

Further, these rulings can be distinguished in the case of share issue since in the context of share issue, invoking the provisions of the treaty do not arise as there is no income at the outset.

The other controversy/question which come to mind is whether by invoking the TPR, the IRA also acquires the right to recharacterise a transaction such that the IRA can attribute/ impute income in the hands of the taxpayers. Is such recharacterisation premature in light of the fact that the GAAR provisions are not operative as yet? Further, once the GAAR provisions are applicable, would the IRA invoke TPR or GAAR to recharacterise such transactions? This is evident in the ruling of Shell discussed earlier, where a share capital transaction has been recharacterised as a debt transaction.

Another controversy on the anvil is in the context of subscription (and subsequent redemption) by an Indian company to the preference shares of an overseas subsidiary. In the said transaction, there is a controversy whether the subscription to capital can be recharacterised as debt (on redemption) which the Indian company should have earned a notional interest.

The transactions involving capital financing, group reorganisations have been brought within the ambit of 'international transactions' by

1 AAR 727 of 2006 (AAR)
2 AAR 788 of 2008 (AAR)
3 326 ITR 276 (AAR)
4 AAR 1006 & 1031 of 2010 (AAR)
5 AAR 817 of 2009 (AAR)
6 AAR 999 of 2010 (AAR)
7 AAR 1044 of 2011 (AAR)

the Legislature's action of amending the TPR. However, one wonders as to whether the objective of such amendment was merely to mandate reporting of the transactions by the taxpayers since the above-mentioned transactions do not give rise to any 'income' under the charging provisions of the Act and hence TPR should be irrelevant (for reasons discussed above). In this scenario, the important aspect to appreciate is that the reporting requirements under TPR can operate independent of section 92(1) and hence the reporting could be required despite no income arising from certain international transactions.

Another aspect which comes to mind is whether Shell and other taxpayers involved in litigation relating to capital financing or group reorganisations can seek protection under Article 9(2) for correlative adjustments or by invoking Mutual Agreement Procedure related provisions under the applicable tax treaty.

B. Associated Enterprises

Article 9 ("Associated Enterprises") of the OECD and UN Model Conventions deals with the subject of transfer pricing adjustments. Article 9 provides for adjustments to profits of enterprises on account of transactions with their associated enterprises with a view to meet the arm's length criteria.

Article 9(1) of the UN Model and OECD Model[8] Conventions read as under:

"1. Where

a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

If the conditions mentioned in Article 9(1) are satisfied, then:

- The profits made by the enterprise from dealings with an associated enterprise can be adjusted to meet the arm's length principle; and
- Such adjusted profits are taxed accordingly.

Some of the controversies relating to Article 9(1) are:

- **Whether the term 'management, control or capital' needs to be interpreted as per the domestic law?**

  In the Indian context, specific instances of deemed participation in management, control or capital are provided in Section 92A(2) of the Act. In light of the same, one needs to question whether the concept of 'management, control or capital', which would be broadly defined in the normal context get restricted on account of the deemed instances under the Act?

- **Whether Article 9(1) can apply even if (hypothetically) the Act did not have Transfer Pricing Regulations?**

  While Article 9 grants tax authorities the right to carry out adjustments to specified transactions, such right cannot be conferred independent of the provisions of the domestic tax laws. In other words, Article 9 merely supplements / reinforces the rights granted to tax authorities under the domestic tax laws (ie the Act in the Indian context). Consequently, the importance of provisions of the Act for giving effect to Article 9(1) is critical.

8 Article 9(1) of the OECD Model is identical to Article 9(1) of the UN Model.

Article 9(2) of the UN Model and OECD Model Convention[9] reads as under:

"2. Where a Contracting State includes in the profits of an enterprise of that State - and taxes accordingly - profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other."

Article 9(2) thus provides a relief mechanism to avoid economic double taxation.

Some of the controversies relating to Article 9(2) are:

- **Are Correlative adjustments compulsory?**

  A correlative adjustment is could be allowed only if the other State considers that the primary adjustment by the first State is not arbitrary and is justified. It would be interesting to observe whether the Indian transfer pricing authorities would grant such correlative adjustments and how they would perceive adjustments by overseas tax authorities?

- **What is the time limit for correlative adjustment?**

  Unless the relevant tax treaty provides a restriction on time limit, correlative adjustments, should be permissible under Article 9(2) without reference to any time limit under domestic tax laws.

- **In which year is correlative adjustment required?**

  The logical thinking would be that the year of primary adjustment and correlative adjustment should be identical. However, one wonders if this exercise should be deferred in cases where the taxpayer/tax authorities are in appeal before the Courts / Tribunals for the primary adjustment since it would be impractical for the tax authorities in the second state to track the developments in relation to the primary adjustments.

C. Mutual Agreement Procedure ('MAP')

Introduction

MAP is an alternate dispute resolution mechanism provided under the DTAA which enables a taxpayer to approach Competent Authorities ('CA') to resolve a dispute relating to its taxation which is not in accordance with the DTAA.

The Article on MAP is provided in Clause/ Article 25 of the OECD Model Convention and reads as under:

"Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

The competent authority shall endeavour, if the objection appears to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting State.

The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention.

9 Article 9(2) of the OECD Model is identical to Article 9(2) of the UN Model.

The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs."

Key features of MAP Provisions

Some of the key features of MAP provisions are discussed as under:

- The MAP provisions only apply in respect of the provisions of the DTAA and not the domestic tax laws.
- It is interesting to note that MAP needs to be invoked by an overseas taxpayer by approaching the competent authority in his State of Residence ('SOR') and not by directly approaching the Indian tax authorities.
- The MAP provisions can be invoked in addition to the remedies available to a non-resident taxpayer under the Act. Thus a taxpayer can simultaneously file appeals before the appellate authorities and seek resolution under the MAP process.
- Typically the MAP procedure would take 3-4 years which is still shorter than the typical litigation lifecycle in India which lasts 7-10 years.
- In case a taxpayer is not satisfied with the resolution under the MAP process, it can choose not to be bound by the MAP and pursue alternative legal remedies.
- Since the MAP process involved competent authorities of both countries, the possibility of obtaining correlative relief for eliminating double taxation are higher.

Key areas of dispute where MAP is invoked – some of the key areas of dispute for which MAP has been invoked are:

- Characterisation of income
- Interpretation of provisions of tax treaty
- Transfer pricing
- Permanent Establishment determination
- Profit attribution, expense claims, and attribution of executive and general administrative expenses to PE.

Practical considerations

- Since the resolution of MAP takes time and the right of filing appeals is time barred under the Act, practically it may be advisable for a taxpayer to file an appeal despite invoking MAP provisions. Subsequently, the taxpayer can request the appellate authorities to keep the appeal proceedings in abeyance until the MAP is disposed off. It would however be the discretion of the appellate authorities to either keep the proceedings in abeyance or dispose off the appeal on merits. In case the appellate authorities decide the appeal in favour of the taxpayer, then the taxpayer can explore the option of withdrawing its application under MAP.
- In certain instances where the Indian tax authorities have raised a demand on taxpayers under normal revenue audit proceedings, the Indian tax authorities have allowed the taxpayer to provide a bank guarantee for the outstanding tax demand. In such cases, the tax demand would not be pursued by the tax authorities until disposal of the MAP application.
- Akin to AAR rulings, MAP solutions are binding only in particular cases which are subject matter of discussions. However, if the issues under consideration relate to treaty interpretation, then the MAP solutions could have persuasive value for other taxpayers / countries as well.
- Unlike appeal proceedings, since MAP proceedings involve discussions between the competent authorities of the two countries, the involvement of the taxpayer in the negotiations and discussions is limited. Further, the taxpayer may be required to furnish additional information during the MAP proceedings,.
- For MAP in the Indian context, Rule 44G and Rule 44H of the Indian Income Tax Rules, 1962 need to be duly considered.

Indian experience of MAP

- In the past, there has been a successful resolution of dispute/settlement for contract software providers under the India-USA DTAA. The Indian tax authorities in India have generally made transfer pricing adjustment on companies engaged in captive software services to associated enterprises overseas on cost plus make up in the range of 25% to 28% for FY 2004-05. In light of the above, several US affiliates of the Indian companies have filed MAP applications in the US to reach a settlement in relation to the transfer pricing adjustments in India. In this regard, the US and Indian CAs have apparently reached a negotiated settlement whereby they have agreed to the full cost mark up for software services at 17.5% for FY 2004-05.
- Further, recently, Finland-headquartered Nokia Group has invoked the MAP provisions under the India-Finland DTAA to resolve its ongoing INR 2,000 crore tax dispute with the Indian tax authorities.
- As regards suspension of tax collection for periods which are not covered under MAP, recently, the Bombay High Court in the case of UPS Worldwide Forwarding Inc[10] held that MAP initiated on the taxpayer for deferment of assessment proceedings and suspension of collection of taxes for past year would also cover subsequent year under the India-USA DTAA. The High Court thus directed the tax department to issue appropriate nil withholding tax certificates in respect of subsequent assessment years to the taxpayer, upon the taxpayer giving an undertaking to keep alive the bank guarantee already furnished to secure the tax department of its dues with respect to tax and interest.

MAP and Advance Pricing Agreements ('APA')

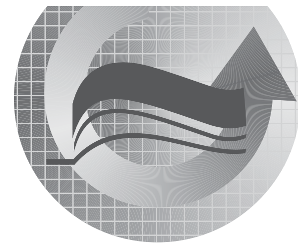
The Indian authorities have recently provided guidance on APA for taxpayers in India. Under the APA, the taxpayer and tax authority can mutually agree on the transfer pricing methodology to be applied and its application for a certain future period of time for covered transactions. A comparative analysis of key aspects of MAP and APA are provided as under:

Particulars	Mutual Agreement Procedure	Advance Pricing Agreement
Nature	i) Specific case agreement; and ii) Interpretative agreements	i) Unilateral; ii) Bilateral; and iii) Multilateral
Who can apply	A taxpayer who is a resident of one of the contracting states under the DTAA	Any person who has undertaken or is contemplating to undertake an international transaction
Binding nature of Decision	Binding on the revenue	Binding on the revenue and taxpayer.

Relationship between Article 9 and MAP

If there is a disagreement over the amount and nature of transfer pricing adjustment or if the tax authorities of the other State do not themselves work out the correlative adjustment, the Mutual Agreement Procedure under Article 25 can be invoked for relief from double taxation. Based on the Model Commentaries, this would be particularly critical in treaties which do not have Article 9(2), which expressly provides for correlative adjustments.

10 UPS Worldwide Forwarding Inc. v ADIT/DIT (Writ Petition No. 1455 of 2013) – Taxsutra.com



Rajendra Nayak, Partner, iT & TP, Ernst & Young LLP

Indian Transfer Pricing (TP) – Revenue's approach on TP Assessment

1. Background

Transfer Pricing has for many years, been cited as the most important international tax issue facing multinational enterprises ("MNEs"). As per the EY's 2013 Global TP Survey, TP continues to be a significant source of controversy between the world's tax authorities and MNEs. Tax authorities worldwide have stepped up their enforcement, and are paying special attention to TP. Globalisation and the inherent advantages enjoyed by India including a large consumer base, low production costs, and a huge skilled work force led numerous MNEs to establish large India operations. This has resulted in a growing number of inter company transfers of tangible goods, intangible property, services, and financing across international borders. India as a TP jurisdiction has positioned itself in a reckonable manner in the global tax scenario.

In the decade that passed since the introduction of TP regime in India, the country has seen significant tax disputes and litigation surrounding TP issues reflecting growing aggressiveness on part of the tax authorities to plug purported erosion of tax base. In the initial years of TP audit, controversies arose over fundamental issues such as time period (single vs. multiple year data) for comparability analysis, choice of TP methodology, application of + 5% range, filters for selecting comparables, etc. Today, although some of these issues are nearing settlement through rulings of appellate bodies and courts and a few through retrospective amendments in the provisions itself, newer and more complex challenges are emerging for taxpayers. In the ongoing TP audit, the Indian tax authorities continued with their rigorous enforcement and new issues continue to emerge such as allocation of location savings, issue of share capital, marketing intangibles etc. Financial transactions, contract R&D services, subsidiaries of foreign brands have all been under the scanner of the tax authorities during audits. There is a sustained surge in the quantum of TP adjustments spanning many industries like Information Technology, Automotive, Pharmaceuticals and Finance & Insurance, as evident from the statistics in the table below:

Financial Year	Number of TP Audits Completed	Number of Adjustment Cases	% of Adjustment cases	Amount of Adjustment (in ` crore)
2004-05	1,061	239	23	1,220
2005-06	1,501	337	22	2,287
2006-07	1,768	471	27	3,432
2007-08	219	84	39	1,614
2008-09	1,726	670	39	6,140
2009-10	1,830	813	44	10,908
2010-11	2,301	1,138	49	23,237
2011-12	2,638	1,343	52	44,531
2012-13	NA	NA	NA	~70,000*

Source : First report of the Rangachary Committee on taxation of development centres and the IT sector
**As per information in public domain*

As could be observed from the above, there appears to be a disproportionate increase in the quantum of adjustments over the years. For instance, between fiscal years 2011 and 2012, the number of taxpayers audited increased by nearly 15%. However, the quantum of adjustments increased by over 90%/100% during the same period. This trend indicates more stringent and aggressive enforcement efforts by the Indian tax authorities. All this has been a result of a distinct focus on the part of Indian tax authorities to train the field officers handling TP cases, creating a special cell of revenue officers to scrutinise cases, coupled with regular training by OECD experts have ensured that the officers are well equipped to tackle complex TP issues.

2. Primary current controversies

Every incremental year of the TP assessment comes with its share of anxiety and surprise to professionals and also rattles the corporates beyond their imagination. In the following sections, some of the key issues which have affected MNCs in recent audits and approach adopted by the Revenue authorities has been discussed:

2.1 Cross-border financing arrangement (Guarantee, share capital valuation, interest on delayed payments)

2.1.1 Issuance of Share capital

Disputes on TP continue to assume innovative forms. TP norms are usually applicable to taxable transactions between related parties. However, in recent assessments, the controversy on valuation of shares issued to AE's has been a cause of concern both for Indian outbound investments and inbound investments. The tax authorities have taken a stand that issue of shares of an Indian company at a price lower than the market price is a valid ground for TP adjustment. Similar is the case of issue of shares by an AE located in an overseas jurisdiction to an Indian company at a price higher than the market price.

The tax authorities have proposed adjustments in the form of notional interests in the hands of the Indian companies by treating or re-characterising the alleged benefit to the AE as loans advanced by Indian companies. Based on published news, though the transaction is not taxable per se and the provisions of the Act, do not permit or authorize any secondary adjustment, the Law Ministry has also endorsed the actions of tax authorities.

2.1.2 Provision of corporate guarantees/loans

As companies with headquarters in India are expanding their global operations, it is not uncommon to have situations where a foreign affiliate of an Indian multinational obtains loans or other credit facility based on an explicit corporate guarantee provided by the Indian parent. Such

arrangements are increasingly under scrutiny to determine whether the Indian parent should be receiving a fee from the affiliate under arm's length situation. Indian companies' outbound structures have gone awry in view of aggressive approach of the tax authorities on financial transactions such as inter-company loans, guarantees and letter of comforts.

The tax authorities have proposed adjustments by computing notional guarantee fees in cases where guarantees/letters of comfort etc., are being issued by Indian entities to lenders of overseas subsidiaries/group companies without examining whether the parent company had actually provided any service to the foreign subsidiary for deserving any guarantee fee. Further, the manner of computation of guarantee fees by the tax authorities with reference to rates charged by Indian banks for domestic bank guarantees is counter to global best practices of TP.

In respect of outbound loans, the tax authorities continue to impute notional arm's length interest on the loan and have proposed adjustments. They tend to ignore considering London Interbank Offered Rate (LIBOR) as the rate for making adjustments. Despite several rulings approving LIBOR as the base rate, the tax authorities continue to make adjustments based on Indian Prime Lending rate in the range of 12-18%.

2.1.3 Interest on overdue AE balances/delayed payments

In the recent round of TP assessments tax-payers have experienced the tendency amongst tax authorities to closely examine cases involving delayed payments by AEs where the delay is beyond the payment terms commercially agreed between the taxpayer and the AE. The tax authorities have sought to impute notional interest income in the hands of the taxpayer in such cases.

2.2 Intra-group services

2.2.1 Management cross-charges

One of the key areas of controversy has been for some time now is the disallowance of management fees paid by Indian tax-payers to the foreign affiliates which continues to be of particular significance. Although such services are a common feature among transnational businesses to bring in specialisation and efficiency in the process and reduce cost, they are perceived by the tax authorities to be a means of lowering the tax base by increasing expenses.

The tax authorities have been persistently targeting such payments. The tax authorities insist on detail documentation to demonstrate the fact that the services were actually rendered by the service provider and the service recipient benefited from such services, whether the benefit is remote or incidental and whether any of these charges relate to shareholder activities or are duplicative. Broad and general explanations offered by the Indian service recipient have not satisfied the Indian tax authorities who insist on detailed back-up supportings, nature of the services, the organisational structure of the Indian entity, the value of the services, the determination of costs, the benefit received by the Indian affiliate, the allocation key adopted and the methodology chosen to defend the payment. Tax authorities have not appreciated taxpayer's arguments that benefits at times could be intangible and cannot be quantified or documented. In the absence of adequate underlying documentation, the tax authorities contend that the services rendered by the foreign affiliate are either "shareholder activities" or do not provide a specific benefit to the Indian affiliate, and therefore, under arm's length conditions do not justify a charge and have disallowed the management fee charge.

2.2.2 Royalty

Payment for the use of intangible property such as a trade marks, know-how and brand names by Indian taxpayers is being scrutinised in great detail by the tax authorities. Tax authoritie's officers often issue detailed notices to taxpayers requiring them to demonstrate the benefit received from the intangible property in order to justify the payment of royalties. Detailed information is sought on the type of intangible, similar arrangements within the

multinational group and the methodology adopted by the taxpayer to arrive at the arm's length price. Tax authorities typically expect the inter-company agreements and TP documentation to provide a detailed description of the intangible. In most cases, the tax authorities reject the taxpayer's analysis and disallow the payment of royalties on the grounds that the taxpayer has not substantiated the benefit received from the intangible. Another reason for disallowance of the royalty payments is the unavailability of organised information on intangible property arrangements in India. In the absence of good-quality comparables and due to the reluctance of tax authorities to rely on foreign databases, they tend to disallow the payments.

2.2.3 Issues specific to the captive information technology (IT)/ BPO industry

Globalisation has led many multinational enterprises to establish IT, research and development ("R&D") and BPO operations in India to take advantage of savings inherent in its low-cost labour market. Considering the significant presence of foreign investment in this sector, it is not surprising that it has attracted the attention of the Indian tax authorities on the appropriate compensation for the Indian entity's contribution to the overall supply chain. Most development centres ("DC's) operate under an arrangement where they work as contract service providers, who perform services under the instructions of the customers. Their services at a stand-alone level do not comprise a commercially saleable intangible asset. Accordingly, the ownership of any intellectual property which may be developed as the result of the services performed by these DCs rests with the service recipients, who alone have the right to exploit the IP so developed.

The Indian tax authorities have claimed that contrary to the taxpayers documentation, they have found evidence that the Indian DCs are undertaking critical functions, both strategically and technically. As a result these entities have developed unique intangibles, which are being passed on to their related parties without providing the Indian DCs appropriate remuneration for the non-routine functions performed by them. The safe harbour rules issued by the CBDT, prescribes different margins for software and contract R&D services and BPO/KPO services. In line with the circular and the safe harbour rules, in the recent assessments the tax authorities have requested for detailed documentation to evidence the entity that undertakes core functions, key decisions and the role of the Indian entity and AEs in the entire supply chain and have made an attempt to classify tax-payers under these broad categories.

Recent audit experience indicates that tax authorities expect the service providers to earn a margin in the range of 25% to 35% on operating costs, as compared to the margins determined by taxpayers, which are in the range of 10% to 15% on costs. While the approach adopted by the tax authorities to justify these margins is by adopting a different approach to accepting or rejecting comparable data as compared to that adopted by the taxpayer, the underlying rationale appears to be to try to shift some of the location savings generated from the multinational enterprise to India. Accordingly, the Indian tax authorities have attributed additional profits to the Indian DCs either by increasing the mark-up on costs earned by these entities or attributing profits earned by their foreign related parties to the Indian DCs.

2.3 Location Savings

Location savings means the net cost savings realised as a result of relocating business operations from a high cost to a low cost jurisdiction. Location savings can be derived by an MNE group that relocates some of its activities to a place where costs (such as labour costs, real estate costs, etc.) are lower than in the location where the activities were initially performed, account being taken of the possible costs involved in the relocation (such as termination costs for the existing operation, possibly higher infrastructure costs in the new location, possibly higher transportation costs if the new operation is more distant from the market, training costs of local employees, etc.).

In the absence of comprehensive guidelines, the treatment of location savings has been an

area of dispute between the taxpayers and the tax authorities. The Indian tax authorities are increasingly giving more importance to location savings and trying to use this argument for claiming higher returns in India. The tax authorities believe that location specific advantages ("location rent") of India such as skilled manpower, access to market, large customer base, superior information and distribution network should also be allocated between AEs. The tax authorities argue that relying on local comparable companies does not capture the benefit of location savings by MNC's and suggest profit split method as a way to calculate 'location rents'.

Recent audits provide evidence that tax authorities in certain locations have also made upward adjustments to the income of the Indian taxpayer by splitting the net location savings between the Indian taxpayer and overseas enterprise. In some cases, the location savings are simply split equally between the Indian taxpayer and overseas enterprise assuming equal bargaining power.

2.4 Marketing Intangibles (AMP – advertising, marketing and promotional expenditure issue)

One of the other hotly debated issues in TP relates to appropriate remuneration for creation of marketing intangibles. The issue has hit manufacturers and traders, from diverse industries as consumer electronics, fast-moving consumer goods, automotive and pharmaceutical sectors, where the industries are characterised by huge marketing expense. These industries also generally operate on a "distributor" or "licensor" model.

The tax authorities apply the so called "bright-line test" derived from the US Tax Court in the case of *DHL Inc and Subsidiaries vs. Commissioner (TCM 1998-461).* Under this test, while a licensee or a distributor is expected to incur a certain level of routine cost to exploit the intangible property which it is provided, it is when the investment crosses the bright line of routine expenditure into the realm of non-routine development expenditures, that economic ownership, likely in the form of marketing intangibles, is created. The Indian tax authorities believe that many of these Indian companies perform significant advertising and manufacturing functions, which are in excess of what a routine distributor/manufacturer in a third party scenario would perform. According to them the Indian taxpayer is therefore rendering service related to enhancing the value of intangible asset (brand in this case) owned by their foreign related party. Hence the Indian entity should not only be reimbursed for the excess advertising and marketing costs that it incurs but also earn an appropriate profit margin on these costs.

To determine the compensation, one of the following approaches is considered by the authorities:

- Disallowance of "excess" marketing expenditure on grounds that it benefited the foreign affiliate;
- Attributing additional income to the Indian affiliate for "recovery" of a portion of the expenditure;
- Reducing the transfer price of the goods purchased by the Indian affiliate; or
- Treating reimbursement actually received as a non-operating item.

The key issue which arises is identifying the return attributable to marketing activities or to the contributions for intangible development or enhancement. A marketing intangible may obtain value as a consequence of AMP expenditures, which can be important to maintain the value of the trade mark. However, it can be difficult to determine whether these expenditures have contributed to the success of a product. Further, the level and nature of AMP spending can be affected by a variety of business factors, such as management policies, market share, market characteristics and the timing of product launches. The benefits of AMP spending may also be realised over a period of time, even though from an accounting perspective the amounts are expensed in the year in which they are incurred. Further, the bright line between routine and non-routine advertising, marketing and promotional expenses could vary for each industry, and even within the

same industry it could be quite company-specific. These issues could make economic benchmarking difficult.

The Special Bench of Income-tax Appellate Tribunal in Delhi ruled on some of these aspects of the issue of marketing intangibles. However, a number of questions still remain unanswered or ambiguous and the decision has largely been in favour of the Revenue.

2.5 Procurement and sales support services

India is one of the key regions for sourcing of consumer goods for export to other markets. It is common for MNE's to establish sourcing or procurement companies in India that undertake routine sourcing functions for their foreign affiliates. Thus, as a "service provider", the Indian affiliate would be expected to earn a comparable return on the operating expense incurred in providing the services. Taxpayers generally undertake an economic analysis by determining the margins earned by comparable independent service providers. The tax authorities have rejected this comparison and attempt to classify activities as high-value procurement activities/allege ownership of unique informational advantages and thereby determine the arm's length price by comparing the taxpayer with risk-bearing traders and determining the comparable return on total operating costs (including purchase costs). Recent experience also suggests that the tax authorities are challenging TP models by alleging that these companies undertake highly integrated functions, providing non-routine benefits to a multinational that are compensable in nature.

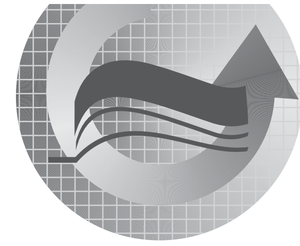
Further, a number of MNE's often engage their Indian affiliates as sales and marketing support service providers. It is common to use a cost-based TNMM or a cost-plus method to remunerate the Indian affiliate on the basis that the Indian entity does not take title to the goods sold and merely provides a service to the principal. In recent audits, tax authorities have started examining whether a cost-based net profit margin indicator appropriately reflects the value of the functions or whether the arm's length remuneration should generally be based on a sales-related indicator.

2.6 Other issues

Some of the other controversial issues that continue to concern the taxpayers include selection of comparable data, time period (single vs. multiple year data) and quantitative parameters to be considered for comparability analysis, use of secret information, exclusion of loss making companies, treatment on losses, choice of TP methodology, etc. While some of the issues are addressed at higher forums, the lower level authorities tend to ignore the principles arising from the appellate rulings and continue to adopt the past approach which is resulting in adjustments.

3. Conclusion

Taxpayers in India find themselves in a challenging position of documenting and defending their transfer price as TP controversies continue to rise. In view of the current trend of TP in India, it is crucial for taxpayers to identify the likely TP red flags or potential risk areas based on their operations, transactions and geographic location and adopt a risk-management approach to TP controversy management. Organisations should strengthen their TP policies as well as the documentation to support them, explore and evaluate risk mitigation strategies and alternate mechanisms with regard to already concluded transactions and future transactions. Further, it needs to be ensured that the public documents are in sync with the tax strategy and reflect actual activities undertaken in the value chain. Taxpayers should consider a more proactive approach to controversy management by preparing for controversy and building a TP defence file in advance of an audit. They should have a dispute resolution strategy in place which considers all available channels of controversy management – under Indian tax law as well as under applicable tax treaties.



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DIRECT TAXES
High Court

1. Section 142A – Reference to DVO cannot be made without rejecting the books of accounts – A.Y. 2005-06

Nirpal Singh vs. CIT (2013) 96 DTR (P&H) 385

The assessee was in the business of running a petrol pump and during the relevant year had constructed the petrol pump, and the said investment was duly recorded in the books of account. The AO during the assessment proceedings referred the said investment to the DVO, and the AO while completing the assessment made addition to the income u/s. 69 on the basis of the DVO's report. The CIT(A) allowed the appeal and the Tribunal held in favour of the Department. On appeal to the High Court, while allowing the appeal held that the AO cannot invoke the provisions of section 142A with rejecting the books of account, and therefore the additions made u/s. 69 cannot be sustained.

2. Section 254 – Subject matter of appeal remaining same – Examination of subject matter from different perspective for the first time – Permissible

CIT vs. Smt. Sanghamitra Bharali (2014) 97 DTR (Gau.) 345

The issue before the Hon'ble High Court was that if the same subject matter appeal is argued in a different way, which was not presented in the same way before the lower authorities, was permissible or not. The High Court held that before the Tribunal an assessee is free to make a fresh approach, present his case from a different perspective and raise new grounds in support of the relief sought by him, provided the subject matter in appeal remains the same.

3. Section 194J; 40(a)(ia) – purchase of rights for 99 years – Does not amount to payment of royalty

Mrs. K. Bhagyalakshmi vs. DCIT (2014) 97 DTR (Mad.) 377

Assessee was in the business of purchase and sale of televisions rights for films. As per the agreement with K Films had assigned world rights of distribution, exhibition and exploitation of films for 99 years without any restriction. The AO held the payment was in the nature of royalty hence the provisions of section 194J were attracted and hence disallowed the expenses towards such rights by invoking the provisions of section 40(a)(ia). The High Court while allowing the appeal of the assessee, held that acquisition

of the commercial rights in a film for 99 years was a transaction which amounted to a sale and therefore the provisions of section 194J would not be attracted, and hence disallowance u/s.40(a)(ia) was not called for.

4. Section 54F – Deduction to be allowed even if construction of the house has commenced before the sale of the capital asset

CIT vs. Bharti Mishra (2014) 98 DTR (Del.) 1

The assessee had sold share the proceeds of which were invested in the construction of a house property and claimed deduction u/s. 54F. The assessee invested part of the amount in the construction and the balance was deposited in a capital gains account. The AO disallowed the deduction as the assessee had commenced construction of the house before the sale of the capital asset, which in this case was shares. On appeal the CIT(A) and Tribunal held in favour of the assessee. On appeal to the High Court, the High Court while dismissing the appeal held that it is not stipulated in anywhere in the section that construction of the house should commence before the sale of the capital asset, and since section 54F is a beneficial provision and is applicable to an assessee when the old capital asset is replaced by a new capital asset in the form of a house, then the said provision should be liberally interpreted and therefore in the instant case the assessee is eligible for deduction u/s. 54F.

5. Section 119 – Revised return of income to be considered as application for condonation which consequently results in refund of legitimate tax

Devdas Rama Mangalore vs. CIT 26 [2014] 41 taxmann.com 508 (Mumbai)

The petition was filed by a Senior Citizen challenging the order passed by the Assessing Officer by dismissing the application for condonation of delay under section 119(2)(b) of the Income-tax Act, 1961 ("the Act") for claiming refund of tax paid. This application was filed by the petitioner seeking refund of tax deducted at source (TDS) by Reserve Bank of India (RBI) on the payment made to him in the year 2004 when he opted for the Optional Early Retirement Scheme (Scheme). The RBI while making the payment to the petitioner under the Scheme had deducted as tax at source an amount of ` 1,64,117/-. However, in his return of income for assessment year 2004-05 filed on 15th October, 2004 the petitioner did not claim any refund of tax as TDS paid by RBI on his behalf nor was the credit on tax utilised to discharge tax payable on any other income. Being aware of the CBDT Cir dated 8-5-2009 and in view of Apex Court decision in the case of *Chandra Ranganathan and Ors. vs. Commissioner of Income Tax 326 ITR 49* held that the amounts received by retiring employees of Reserve Bank of India opting for the scheme are eligible for exemption under section 10(10C) of the Act. In view of the above the petitioner filed a revised return of income on 8th September 2011 claiming benefit of exemption available to the Scheme under section 10(10C) of the Act which consequently would result in refund of ` 1.64 lakhs paid by RBI as TDS. However, there was no response to the above revised return of income from the respondent-revenue. Further the Peitioner filed an application with the Commissioner of Income Tax under section 119(2)(b) of the Act seeking condonation of delay in filing his application for refund in the form of revised return of income for assessment year 2004-05. The respondent revenue by the impugned order dismissed the application under section 119(2)(b) of the Act on the ground that in

view of Instruction No. 13 of 2006 dated 22 December, 2006 by the CBDT an application claiming refund cannot be entertained if the same is filed beyond the period of 6 years from the end of the assessment year from which the application is made. By filing a Writ Petition in High Court, the Hon'ble court allowed the Writ Petition and held that the application under section 119(2)(b) of the Act was being denied by adopting a very hyper technical view that the application for condonation of delay was made beyond 6 years from the date of the end of the assessment year 2004-05. The court also held that the revised return of income which was filed on 8th September, 2011 should itself be considered as an application for condonation of delay under section 119(2)(b) of the Act and the refund was granted to the Petitioner.

6. Section 24 – Interest on interest paid due to default in payment of home loan instalments is not deductible u/s. 24

Master Naman Kumar vs. CIT, Patiala [2014] 41 taxmann.com 10 (Punjab & Haryana)

During proceedings of assessment for the periods ranging from 1987-88 to 1991-92, it was noticed that the assessee was having 25% share of rental income of SCO Nos. 57, 58 and 59, Sector 17, Chandigarh. It was also noticed that the assessee had been claiming compound interest on loan raised for construction of the property, whereas during the assessment proceedings, it was found that only simple interest was admissible to the assessee. The AO falling in line with the assessment order for the year 1984-85 held that the assessee was to be entitled only simple interest on the principal amount outstanding during the year out of the loan raised by the assessee. In short, interest @ 15% per annum on outstanding principal amount of ` 5,05,000/- was allowed. Both CIT(A) & Tribunal disallowed interest on interest which had been deducted by the assessee as an allowable deduction and allowed only simple interest as deduction. On a reference in High Court where the question of law was whether simple interest or compound interest charged by the bank on the amount borrowed by the assessee from it for raising construction was to be allowed or not?The hon'ble High Court affirmed the findings of lower authorities and held in favour of revenue by taking a view that income of the assessee under the head "income from house property" is to be computed for the purpose of income tax after making certain deductions as are envisaged in Section 24 of the Act. Section 24(1)(vi) of the Act stipulates that amount of interest payable on capital borrowed, *inter alia*, for construction of the property yielding income, was an admissible deduction. It was thus evident that only interest payable on such borrowed capital was to be deducted while computing income chargeable to income tax under the head 'Income from house property". In short, interest paid on interest levied by the bank, because of non-payment of instalments of borrowed capital to the bank, did not qualify for an admissible deduction.

Good humor is the health of the soul, sadness is its poison.

— *Lord Chesterfield*

Jitendra Singh & Sameer Dalal
Advocates

DIRECT TAXES
Tribunal

REPORTED

1. Assessment – issue of notice under section 143(2) of the Act at the old address despite intimation of new address – service of notice under section 143(2) of the Act at the new address after the prescribed time limit – notice under section 143(2) is barred by limitation period and therefore, assessment order is void *ab initio*. A.Y. 2006-07

Abacus Distribution Systems (India) (P) Ltd vs. DCIT (2014) 97 DTR (Mumbai)(Trib) 1

The assessee filed its return of income for A.Y. 2006-07 on 20-11-2006 declaring nil income. As there was a change in the communication address, the assessee filed a letter dated 22-11-2006 and intimated the A.O. new address. However, the A.O. issued notice under section 143(2) of the Act dated 28-11-2007 at the old address of the assessee which has not been served. Thereafter, the second notice under section 143(2) was issued on 11-12-2007 at the new address communicated by the assessee. The assessee before the Appellate Tribunal raised legal issue with respect to the validity of the notice issued under section 143(2) of the Act as the same was barred by limitation period. The Appellate Tribunal held in favour of the assessee by observing that the A.O. having sent the notice under section 143(2) at the old address of the assessee despite the intimation of the assessee about the change of address and failed to serve the said notice upon the assessee within the statutory time-limit as provided under second proviso to section 143(2) and the second notice which has been served upon the assessee being clearly barred by limitation, there was no compliance of the mandatory requirement of serving the notice under section 143(2) within the time-limit and, therefore, the impugned assessment order is void *ab initio*.

2. Capital or revenue expenditure – Vehicle lease rental – lessor is responsible for making payment towards insurance premium, road tax and repair and maintenance –ownership of the vehicle remains with the lessor – lease is an operating lease – lease rentals paid are allowable as revenue expenditure. A.Y. 2006-07

Godrej Consumer Products Ltd vs. ACIT (2014) 97 DTR (Mumbai)(Trib.) 33

The assessee in the return of income claimed expenditure incurred on lease rental of the cars. During the course of assessment proceedings the A.O. observed that the assessee had capitalised leased assets and is writing off the cost of

such assets in the books of account by way of depreciation over the period of lease. However, in computation of total income, the depreciation on such leased assets had been disallowed and added back to the total income. The A.O. after considering the explanations of the assessee considered the lease transaction as finance lease and treated the lease returns paid as capital expenditure and disallowed the claim of the assessee for treating the same as revenue expenditure. On Appeal, the first Appellate Authority confirmed the action of the A.O.

The assessee, being aggrieved by the order passed by Ld. CIT(A) preferred further appeal to the Income Tax Appellate Tribunal, Mumbai. The Appellate Tribunal held in favour of the assessee by observing that assessee having acquired vehicles under a lease agreement which stipulates that the lessor is to bear the insurance premium, road tax and repair and maintenance expenses of the vehicles and that the vehicles are to be returned to the lessor on the expiry of the terms of the lease, the lease in question is an operating lease and not a finance lease and consequently, the lease rentals paid during the relevant Assessment Year allowable as revenue expenditure, more so as the assessee has not claimed any depreciation of the vehicles.

3. Charitable trust – Registration under section 12A – allegation of collection of donation/capitation fee without any proof – cancellation of registration under section 12A not justified A.Y. 2003-04

ACIT vs. Prathima Educational Society (2014) 97 DTR (Hyd.)(Trib.) 132

The assessee is running a medical college at Karimnagar. The CIT issued a show cause notice to the assessee society on the basis of certain report of the A.O., proposing cancellation of the registration under section 12AA, by exercising the power conferred under s. 12AA(3) of the Act. The CIT after examining the various material found and seized at the time of search and the statements recorded at the time of search, observed that the conduct of the Society is not in accordance with the objects for which it was established. He noted that the assessee society admitted students under management quota in consideration of amounts over and above the prescribed fees by the Government, which clearly established the intention of the assessee to earn profit. The CIT, therefore, cancelled the registration *vide* impugned order dated 22-3-2012 passed under section 12AA(3) of the Act.

The assessee, being aggrieved by the order passed by Ld. CIT preferred further appeal to the Income Tax Appellate Tribunal, Mumbai. The Appellate Tribunal held in favour of the assessee by observing that assessee-society being engaged in running a medical college, it cannot be said that the activities of the assessee are not genuine or that the activities are not being carried on in accordance with its object; department having failed to adduce sufficient evidence to show that the assessee had actually collected capitation fees from its students registration granted to the assessee-society under section 12AA cannot be cancelled.

4. Charitable trust – Exemption under section 11 – interest income earned on surplus/corpus fund kept as FDRs – eligible for exemption under section 11 of the Act – A.Y. 2009-10

DCIT vs. Nehru Prasutika Hospital Samiti (2014) 97 DTR (Agra)(Trib.) 357

The assessee society is running a maternity hospital at Aligarh. The assessee society is registered under section 12AA of the Act. The A.O. during the course of assessment proceedings found that the interest income on the FDRs exceeds 15% of receipts allowed to be treated as Charitable activity. The A.O. therefore, disallowed the interest exceeding 15% to the tax. On appeal, the first Appellate Authority held that the interest earned on surplus/corpus fund is directly linked to the main activity of the trust and therefore the exemption under section 11 is allowable. The department, being aggrieved by the order passed

by Ld. CIT(A) preferred an appeal before the Appellate Tribunal. The Tribunal confirmed the order passed by the Ld. CIT(A) and held that the assessee has invested its funds in FDRs on which the assessee earned interest, which is applied towards the objects of the assessee society. The funds invested in FDR have been shown in the Balance Sheet and is the property of the assessee-society. Merely because the assessee earns interest on its surplus/corpus funds would not lead to the fact that the assessee exists for profit purpose.

5. Capital Gains – Exemption under section 54B and 54F – Investment made in the name of married daughters – Term 'assessee' used in sections 54B and 54F cannot be extended to include major married daughters – assessee not entitled to exemption.

Ghanta Vijaya Lakshmi vs. ITO (2014) 97 DTR (Visakha)(Trib.) 423

The assessee during the relevant Assessment Year sold agricultural land. Thereafter, the assessee purchased another agricultural land in the name of her younger daughter and also a flat in the name of her eldest daughter. While computing the Long Term Capital Gain, on sale of agricultural land, the assessee claimed deduction under section 54B in respect of agricultural land purchased in the name of younger daughter and also deduction under section 54F in respect of the flat purchased in the name of eldest daughter. The A.O. disallowed the claim of deduction under sectios 54B and 54F of the Act by holding that the properties were not registered in the name of the assessee. The assessee's claim of Benami was also rejected on the ground that the Benami Transaction (Prohibition) Act provides exemption to property purchased in the name of unmarried daughters only. Being aggrieved, the assessee preferred an appeal before the first Appellate Authority. The Ld. CIT(A) however dismissed the appeal filed by the assessee and thereby confirmed the action of the A.O. in disallowing the deduction. The assessee carried the matter in further appeal before the Appellate Tribunal. The Tribunal also confirmed the action of the lower authorities by observing that the term 'assessee' used in sections 54B and 54F cannot be extended to include major married daughters and, therefore, assessee is not entitled to exemption under sections 54B and 54F in respect of investments made in the names of her married daughters who are majors.

UNREPORTED

1. Charitable or religious trust – Cancellation of registration – Section 12AA, read with section 2(15), of the Income-tax Act, 1961 – Trust created for promotion and development of sports – Commissioner cancelled registration of assessee-trust by invoking provisions of section 12AA(3) by observing that assessee-trust had arranged international matches of cricket and, in turn, had received TV subsidy/subvention income, viz, sharing of TV broadcasting rights, and advertisement sales income; and, thus, it had carried out activities in nature of trade, commerce or business in view of first proviso to section 2(15) – Registration had been cancelled by Commissioner on basis of amended provisions of section 2(15) – action taken by Commissioner did not fall within permissible limits of section 12AA(3) and therefore, impugned order cancelling assessee's registration was bad in law.

Saurashtra Cricket Association vs. CIT [I.T.A. No.: 64 / Rajkot / 2013; Order date: 25-10-2013; Rajkot Bench]

The Commissioner cancelled the registration of the assessee-trust by invoking provisions of section 12AA(3), observing that the trust was arranging international matches of cricket and in turn had received TV subsidy/subvention income like, sharing of TV broadcasting rights income and

advertisement sales income. The Commissioner was of the view that the assessee-trust had carried out the activities in the nature of trade, commerce or business in view of the first proviso to section 2(15) and, therefore, the objects of the assessee-trust are no longer's charitable in nature.

On appeal the Tribunal held that the Registration has been cancelled by Commissioner on the basis of amended provisions of section 2(15). The action taken by the Commissioner, does not fall within the permissible limits of section 12AA(3). Section 12AA(3) of the Act does not extend the power to Commissioner for re-examination of the 'objects' of the trust or institution once registration has been granted under section 12A. The insertion of first proviso to section 2(15) of the Act with effect from 1-4-2009 would not have any bearing on section 12AA(3) since it does not extend to the objects of the trust or institution but only to its activities as stated therein. The issue raised by the Commissioner, in the order regarding the activities of the trust can be examined by the Assessing Officer in the appropriate proceedings. The findings given by the Commissioner in the order is not permissible keeping in view the limited power available to him under section 12AA(3). Therefore, it would be open for the Assessing Officer to consider the issue regarding the applicability of the proviso to section 2(15) of the Act, in the course of assessment proceedings of relevant year.

2. Remission or cessation of trading liability – Section 41(1) read with section 28(iv) of the Income-tax Act, 1961 – Assessee received a sum as advance for export of goods and same had been appearing in books of account of assessee regularly year after year – Assessee did not make export against said advance nor said amount was returned – The amount was not written off in books of account – It could not be said that any liability had ceased to exist and same could not be added to income of assessee (A.Y. 2007-08)

Asia Business Ventures (P.) Ltd. vs. ITO - [I.T.A. No. 430 / M / 2011; Order dated: 8-11-2013; Mumbai Bench]

The Assessing Officer observed from balance sheet of the assessee that under the head, current liabilities an amount was reflected being advance against exports. The assessee submitted before the A.O. that the said amount was received from a foreign company in 1997, for the purpose of exports. Subsequently, exports could not be made as the required goods could not be identified and balance was still due and payable. The assessee also filed a confirmation from the party before the A O. As the assessee had not made any export in lieu of advance received even after ten years of receipt of advance, the A.O. taxed the advance as income under section 41(1) of the Act and added back to the total income of the assessee.

On appeal the Tribunal held that, the assessee had not made export against the said advance. The amount is not returned to the foreign company till date. The assessee has admittedly stopped export business and is in the business of advisory as well as in share dealing. However, it was not in dispute that the said amount is shown as advance in the balance sheet of the assessee. The liability was also shown in the balance sheet even for the relevant previous year. Therefore, the liability has been acknowledged by the assessee. As the amount has not been written off by the assessee in its books of account, it cannot be said that the liability has ceased to exist. The Tribunal further noted that since the said amount received by the assessee in January, 1997 and the same was appearing in the books of account of the assessee since then, genuineness of the transaction as well as creditworthiness of the party could not be considered in the assessment year under consideration for making the addition under section 41(1) read with section 28(iv) of the Act.

CA Sunil K. Jain

DIRECT TAXES
Statutes, Circulars & Notifications

Notifications

Income-tax (Nineteenth Amendment) Rules, 2013 – Amendment in Rule 114 and Substitution of Form Nos. 49A and 49AA being application for allotment of Permanent Account Number

The Central Board of Direct Taxes made the rules further to amend the Income-tax Rules, 1962 as the Income-tax (19th Amendment) Rules, 2013 which shall come into force on the date of their publication in the Official Gazette.

Form No. 49A being Application for Allotment of Permanent Account Number applicable in the case of Indian Citizens/Indian Companies/Entities incorporated in India/Unincorporated entities formed in India and Form No. 49AA applicable for Individuals not being a Citizen of India/Entities incorporated outside India/Unincorporated entities formed outside India have been substituted. The documents required to be accompanied with aforesaid applications as proof of identity; address and date of birth of such applicant have been specified in the said notification.

According to the notification the Income Tax Department will now accept Aadhaar Card as a proof of identity and address for issuance of Permanent Account Number (PAN). Aadhaar is a 12-digit individual identification number issued by the Unique Identification Authority of India (UIDAI) on behalf of the Government of India. Now, Aadhaar Card can be used for getting a PAN, which is a ten-digit alphanumeric number, issued in the form of a laminated card, by the Income Tax Department. Other documents for identify accepted by the Income Tax Department include elector's photo identity card, ration card having photograph of the applicant, passport, driving licence, arms licence and photo identity card issued by Government or a public sector undertaking. Documents for address proof include electricity bill, landline telephone or broadband connection bill, consumer gas connection card or book or piped gas bill, bank account statement, passport of applicant or even spouse, among others.

Recently, the Reserve Bank of India had also notified that Aadhaar Card as a valid proof for opening of a bank account under the Know Your Customer (KYC) scheme.

(Notification No. 96/2013 dated 23-12-2013)

Section 35(1)(iii) of the Income-tax Act, 1961 – Scientific research expenditure – Approved social science or statistical research Associations or Institutions

The organisation Salim Ali Centre for Ornithology and Natural History, Coimbatore (PAN-AAATS1101Q) has been approved by the Central Government for the purpose of clause (iii) of sub-section (1) of section 35 of the Income-tax Act, 1961, from Assessment Year 2013-14 onwards in the category of 'Scientific Research Association' activities subject to the conditions mentioned in the said notification.

(Notification No. 97/2013, dated 26-12-2013)

Section 35AC of the Income-tax Act, 1961 – Eligible projects or schemes, expenditure on – Notified eligible projects or schemes

The Central Government notified two institutions in the State of Gujarat, and approved the eligible projects/schemes to be carried on by the said institutions and the estimated cost thereof and also specified the maximum amount of such cost which may be allowed as deduction under the said section 35AC for the period of approval.

The Notification shall remain in force for a period of three years in relation to financial years 2013-14, 2014-15 & 2015-16 in respect of the projects or schemes mentioned in the said notification.

(Notification No. 74/2013 dated 27-12-2013)

Section 90 of the Income-tax Act, 1961

- **Agreement for avoidance of double taxation and prevention of fiscal evasion with Albania**

  An agreement between India and the Council of Ministers of Republic of Albania for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital has been signed. The Central Government directed that all the provisions of said agreement between India and the Council of Ministers of Republic of Albania for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, as set out in the Annexure to the said notification, shall be given effect to in the Union of India with effect from date of entry into force of said agreement i.e., the 4th day of December, 2013.

  (Notification No. 2/2014 – dated 6-1-2014)

- **Agreement for exchange of information with respect to taxes with Belize**

  An agreement between India and the Government of Belize for the exchange of information with respect of taxes was signed at Belmopan. The Central Government directed that all the provisions of said agreement between India and the Government of Belize for the exchange of information with respect to taxes as set out in the Annexure to the said notification, shall be given effect to in the Union of India with effect from the date of entry into force of said agreement i.e., the 25th day of November, 2013.

  (Notification No. 3/2014 – dated 7-1-2014)

Section 80D of the Income-tax Act, 1961 – Health Insurance Premia – Deduction in respect of – Notified health service scheme

The Central Government notified the Contributory Health Service Scheme of the Department of Space for the purposes of section 80D for the assessment year 2014-15 and subsequent assessment years.

(Notification No. 6/2014 [F. No. 149/97/2013-TPL], dated 15-1-2014)

Circulars

Rent – Clarification regarding TDS under Chapter XVII-B on Service Tax component comprised payments made to residents

The Board earlier *vide* Circular No. 4/2008 dated 28-4-2008 clarified that tax is to be deducted at source under section 194-I of the Income-tax Act, 1961 on the amount of rent paid/payable without including the service tax component. Representations/letters have been received by CBDT seeking clarification whether such principle can be extended to other provisions of the Act also.

Attention of CBDT has also been drawn to the judgment of the Hon'ble Rajasthan High Court dated 1-7-2013, in the case of *CIT (TDS) Jaipur vs. Rajasthan Urban Infrastructure (Income-tax Appeal No. 235, 222, 238* and *239/2011)*, holding that if as per the terms of the agreement between the payer and the payee, the amount of service tax is to be paid separately and was not included in the fees for professional services or technical services, no TDS is required to be made on the service tax component u/s 194J of the Act.

The Board now decided that wherever in terms of the agreement/contract between the payer and the payee, the service tax component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source under Chapter XVII-B of the Act on the amount paid/payable without including such service tax component.

(Circular No. 1/2014 – dated 13-1-2014)

Instructions

Section 197 of the Income-tax Act, 1961 – Deduction of Tax at Source – Certificate of lower deduction or Non-deduction of Tax at Source under section 197

As per the Citizens Charter the time line prescribed for a decision on application for no deduction of tax or deduction of tax at lower rate is one month. Instances have been brought to the notice of the Board, about considerable delay in issuing the lower/non deduction certificate under section 197 by the jurisdictional Assessing Officers.

CBDT *vide* these instructions directed that the commitment to tax payers as per the Citizens Charter must be scrupulously adhered to by the Assessing Officers and all applications for lower or no deduction of tax at source filed u/s 197 of the Income-tax Act, 1961 must be disposed of within the stipulated time frame as above.

(Instruction No. 1/2014 – dated 15-1-2014)

Press Releases

Gross Direct Tax Collection during April-December of F.Y. 2013-14

Gross direct tax collection during April-December of the F.Y. 2013-14 is up by 12.33 per cent as against in the same period last year. While gross collection of corporate taxes has shown an increase of 9.35 per cent, gross collection of Personal income tax is up by 18.53 per cent. Net direct tax collection is up by 12.53 per cent in the same period in the last fiscal. The collection of STT showed the growth of 4.04 per cent while the Wealth Tax has posted a growth of 11.92 per cent.

(Press Release No. 402/92/2006-MC dated 6-1-2014)

Section 2(15) of the Income-tax Act, 1961 – Charitable /religious purpose – Action taken against four specified cricket associations having been found engaged in certain activities which were considered commercial in nature in view of amended provisions of section 2(15)

The Income Tax authorities have looked into the affairs of the four cricket associations, namely Saurashtra Cricket Association, Baroda Cricket Association, Kerala Cricket Association and Maharashtra Cricket Association and have found that these cricket associations were engaged in certain activities which were considered commercial in nature in view of the amended provisions of Section 2(15) of the Income-tax Act, 1961. Consequently, the scrutiny of assessments in these cases has resulted into the withdrawal of tax-exemption. Past assessments in these cases have also been reopened by the Department to examine the correctness of their claim for income tax exemption during the periods concerned.

(CBDT Press Note, dated 9-1-2014)

Change in procedure for PAN allotment process w.e.f. 3-2-2014

The procedure for PAN allotment process will undergo a change w.e.f. 3-2-2014. From this date onwards, every PAN applicant has to submit self-attested copies of Proof of Identity (POI), Proof of Address (POA) and Date of Birth (DOB) documents and also produce original documents of such POI/POA/DOB documents, for verification at the counter of PAN Facilitation Centres. The copies of Proof of Identity (POI), Proof of Address (POA) and Date of Birth (DOB) documents attached with PAN application form, will be verified vis-a-vis their original documents at the time of submission of PAN application at PAN Facilitation Centre. Original documents shall not be retained by the PAN Facilitation Centres and will be returned back to the applicant after verification.

(CBDT Press Release, dated 24-1-2014)

CA Tarunkumar Singhal & CA Sunil Moti Lala

INTERNATIONAL TAXATION
Case Law Update

A] AUTHORITY FOR ADVANCE RULINGS

I Section 245R(2) – Mere filing of return of income before date of filing application for advance ruling does not attract the bar under Section 245R(2) of the Act since no notice under Section 143(2) was issued before the date of filing application

Mitsubishi Corporation, Japan, In re [2013] 40 taxmann.com 335 (AAR)

Facts

1. The applicant, a company incorporated in Japan and a tax resident of Japan, established a Branch Office in India in April, 2008 after obtaining the necessary approvals from the Reserve Bank of India.

2. The activities carried out by the Branch Office in India primarily relate to provision of support services to the applicant.

3. The applicant received offshore supplies contract from Power Grid Corporation India Ltd. and entered into two separate contracts with the Power Grid Corporation India Ltd., i.e. Offshore supply contract and Onshore service contract.

4. The applicant sought advance ruling on the taxability of the consideration received under the Offshore supply contract and whether MC Japan and Allcargo Global Logistics Limited ("assignee"), for the purpose of executing the Onshore service contract for all services to be performed in India, could be assessed as independent companies under Section 2(31)(iii) of the Income-tax Act ("the Act") in India or as an Association of Persons ("AOP") under Section 2(31)(v) of the Act.

5. The Department objected to the admissibility of the application stating that return of income was filed before filing the application.

Ruling

1. The Hon'ble AAR observed that the ruling of SEPCO III Electric Power Construction Corporation [2012] 340 ITR 225 (AAR) and NetApp BV [2012] 347 ITR 461 (AAR) confirmed by Delhi High Court in [2012] 253 CTR 164 (Delhi) were based on the premise that by filing a return, an assessee invites adjudication of the question arising out of the returns. From an analysis of provisions under Sections 143(2) and 142(1) of the Act, it is seen that this was not so. By issue of notice under Section 143(2) only, the AO assumes jurisdiction to adjudicate all the questions arising out of the return. In the case of Jagtar Singh Purewal reported in (1995) 213 ITR 512, this Authority held that though the applicant had declared amount in question

in return, the application for advance ruling was maintainable as there was no pending dispute between the applicant and the Income-tax Department because the return had been processed under Section 143(1) and the refund as prayed for by the applicant had been granted. Secondly, even in the return the assessee raised no dispute regarding the assessability of the amount. On the other hand, he voluntarily showed it and paid tax thereon claiming refund of only the balance. Further, in the case of *Hyosung Corporation Korea [2013] 36 taxmann.com 150 (AAR)* it was held that mere filing of return does not attract bar on the admission of the application as provided in Section 245R(2) of the Act.

2. The Hon'ble AAR held that that only when the issues are shown in the return and notice under Section 143(2) is issued, the question raised in the application will be considered as pending for adjudication before the Income-tax Authorities. In the present case, the return of income was filed before filing the application. However, notice under Section 143(2) was issued after the date of the application. Thus, following the ruling in Hyosung Corporation it ruled that the question raised by the applicant was not already pending before the Income-tax Authorities and therefore, the application was maintainable.

II. Section 245R(2) – Mere filing of return of income before date of filing application for advance ruling does not attract the bar under Section 245R(2) of the Act since no notice under Section 143(2) was issued before the date of filing application

Aircom International Ltd., In re [AAR No. 1329 of 2012 Order dated 10th January, 2014]

Facts

1. Aircom International Ltd. ("the applicant"), a company incorporated in England and Wales, entered into a Management Service Agreement (MSA) with its wholly owned subsidiary in India, Aircom India. Under the agreement, the applicant provided various Management Support Services to Aircom India with a view to rationalise and standardise the business conducted by Aircom India in India in accordance with the international best practices.

2. The applicant sought an advance ruling on the taxability in India in respect of the payments received from Aircom India under the India – UK Double Taxation Avoidance Agreement ("the DTAA").

3. The Revenue objected to the admissibility of the application stating that return of income was filed before filing the application.

4. The applicant submitted that mere filing of return of income does not attract the bar unless the question raised in the application is an issue pending for adjudication before the Income-tax Authorities. It further submitted that particulars of the issues raised before the Authority for Advance Rulings were not disclosed in the return of income filed.

Ruling

1. The Hon'ble AAR observed that in the present case return of income was filed before filing application to the Authority for Advance Rulings. However, notice under Section 143(2) was issued after the application was filed before the Authority. There was no dispute about the facts. Relying on the decision in the case of *Hyosung Corporation Korea [2013] 36 taxmann.com 150 (AAR)* and in other cases it ruled that the question cannot be said to be already pending before the Income-tax Authorities, as no notice under Section 143(2) was issued before filing the application though return was filed.

2. Accordingly, the Hon'ble AAR admitted the application under Section 245R(2) of the Act.

III. Section 245R(2) – Since not only return of income was filed but even

notices under Sections 143(2) and 142(1) were already issued before filing of the application and the particulars of the issue were shown in the revised return in the form of TDS details, the bar under Section 245R(2) was attracted.

J & P Coats Limited, In re [AAR No. 1077 of 2011 Order dated 10th January, 2014]

Facts

1. J&P Coats Limited ("the applicant"), a company incorporated under the laws of the U.K., entered into a Master Global Framework Agreement with BT UK under which BT UK was to provide the Coats Group entities with two-way transmission data through telecom bandwidth and interconnects the Coats group companies of UK located across the globe with managed wide area network (referred to as "data connectivity"). The applicant, in turn was to recoup the cost so incurred to its Coats group companies for the connectivity utilised.

2. As part of the agreement entered into between the applicant and BT UK, Madura Coats Private Limited ("MCPL"), an Indian company was also provided connectivity. The applicant had also entered into an Applications Support and Wide Area Network Support Services Agreement ("Agreement") with MCPL for recouping the cost so incurred on behalf of MCPL based on usage.

3. The applicant sought an advance ruling on the taxability in India as regards the payments received by it.

4. The Revenue objected to the admissibility of the application submitting that the return of income was filed prior to the date of filing of advance ruling application. It further pointed out that even notices under Sections 143(2) and 142(1) were issued before the filing of the application.

Ruling

1. The Hon'ble AAR held that only when the issues are shown in the return and notice under Section 143(2) is issued, the question raised in the application will be considered as pending for adjudication before the Income-tax Authorities.

2. It observed that in the present case not only return of income was filed but even notices under Sections 143(2) and 142(1) were already issued before filing of the application. Return of income for the relevant assessment year was filed on 30-9-2008 and a revised return was filed on 31-3-2010 i.e. before filing the application to the Authority for Advance Rulings on 19-5-2011. Notice under Section 143(2) was issued on 20-9-2010 which was before filing the application. The assessment was also completed under Section 143(3) of the Act by the Assessing Officer on 1-2-2012.

3. Further, the submission of the applicant that the particulars of the issue were not shown in the return was also not factually correct as it was found that in the revised return, the transaction was shown in the form of details of TDS. It thus held that the question was already pending before the Income-tax Authorities and the application was barred by Proviso (1) of Section 245R(2) of the Act.

IV. India-Netherlands DTAA – When "considerable experience, knowledge and expertise" of the holding company is to be rendered for which payments are made by the Indian company, the payments fall within definition of fees for technical services under Section 9(1)(vii) – However, since the assessee merely took assistance of the holding company in its business activities outside India and there was no material to suggest that the technical know-how, skill, knowledge and expertise were transferred to the assessee so as to enable it to apply this technical know-

how etc., the requirement of "make available" was not satisfied

Endemol India (P) Ltd., In re [2013] 40 taxmann.com 345 (AAR)

Facts

1. The applicant, Endemol India Private Limited, a resident company incorporated under the Companies Act, 1956 is engaged in the business of providing and distributing television programmes.

2. The applicant requires assistance from Endemol Holding to carry out its business efficiently and in a profitable manner and for that purpose entered into a Consultancy Agreement with Endemol Holding B.V., a tax resident Netherlands, on 10-1-2011 for procuring certain consultancy services from Endemol Holding.

3. Under the agreement, Endemol Holding would provide the applicant services such as General Management, International Operations, Legal advisory, Tax Advisory, Controlling and Accounting & reporting, Corporate Communications, Human Resources, Corporate Development and Mergers & Acquisitions.

4. The applicant sought an advance ruling on the taxability in India of amount paid to Endemol Holdings under the agreement.

Ruling

1. The Hon'ble AAR observed that since material evidences of the actual services rendered were not furnished by the applicant reliance had to be placed on the services mentioned in the Consultancy Agreement. Article 1 of the consultancy agreement clearly showed that it is the "considerable experience, knowledge and expertise" of the holding company that is to be rendered and for which payments are to be made. Also, from the nature of the services listed in Schedule 1 to the Management Consultancy Agreement it is clear that it requires technical knowledge, experience, skill, know-how or processes. Thus, they cannot be termed as merely administrative and support services as tried to be made out by the applicant. The services rendered by Endemol BV to the applicant cannot but be technical in nature. Therefore, the services rendered were technical services both under the provision of the Act and under the India-Netherlands Double Taxation Avoidance Agreement ("the DTAA") subject to fulfilment of requirements of the "make available" clause.

2. The Hon'ble AAR observed that the requirement of "make available" is met if the technology, knowledge or expertise can be applied independently by the person who obtained the services. In this case the applicant merely took assistance of the Holding company in its business activities outside India and there was no material to suggest that the technical know-how, skill, knowledge and expertise were transferred to the applicant so as to enable the applicant to apply this technical knowhow, etc. independently. Therefore, the requirement of the "make available" clause in the Article 12(5) of the DTAA was not satisfied and hence the payment for the services rendered by Endemol BV would not come under "Fees for technical services" under the DTAA.

3. It further held that there was no material to show that Endemol Holding had any presence in India. There was also no material to suggest that the applicant was fully dependent on Endemol. Thus Endemol did not have any PE in India and the payment would not be taxable as business income in India under the DTAA.

V. In view of CBDT's Circular No. 715, dated 8-8-1995, services rendered by non-resident for production of programmes for purpose of broadcasting and telecasting shall be specifically characterised as 'work' under Section 194C – Since services are categorised as 'work' under Section

194C the income therefrom would be treated as business income and thus the payment made could not be treated as Fees for Technical Service.

Endemol India (P) Ltd., In re [2013] 40 taxmann.com 340 (AAR)

Facts

1. The applicant, Endemol India Private Limited, a resident company incorporated under the Companies Act, 1956 was engaged in the business of providing and distributing television programmes.

2. During the financial year 2010-11, the applicant had produced the reality show "Wipe Out" ('the show') which was aired by Viacom 18 Media Private Limited on Imagine TV. As per the format of the show the shooting was to take place outside India (primarily in Argentina). For the purpose of show, the applicant has engaged Endemol Argentina SA ("Endemol ARG") for providing line production services in Argentina and accordingly entered into an agreement in the form of DEAL MEMO.

3. The applicant sought an advance ruling with regards to its withholding tax obligations on the payments made to Endemol ARG in respect of the services rendered.

Ruling

1. The Hon'ble AAR observed that as per the agreement, the applicant has to pay the amount towards composite services (including provision of equipment). Details of the agreement did not support the argument that the services provided by Endemol ARG to the applicant are only administrative and logistical services for shooting the programme outside India. On perusal of Annexure 1 to production services agreement, it was evident that the main provision of the services were technical crew, production crew and technical equipments. The other services were ancillary necessary for the technical/production crew and the technical equipments only.

2. As regards the applicability of Section 194C vis-à-vis Section 194J, the Hon'ble AAR held that if there is a specific provision for specific item of payment that provision will override the general provision. It observed that the Delhi High Court in the case of *CIT vs. Prasar Bharati [2007] 158 Taxmann 470 (Delhi)* held that broadcasting and telecasting including production of programmes for such broadcasting and telecasting do not fall under the provision of Section 194J as they are specifically covered by definition of "work" in Section 194C of the Act. Also, CBDT's Circular No. 715, dated 8-8-1995 stated that payments made to advertising agencies for production of programmes, which are to be broadcasted / telecasted, would be subject to withholding tax under Section 194C of the Act.

3. The Hon'ble AAR thus held that since the payments made by the applicant to Endemol were for production of programmes for the purpose of broadcasting and telecasting, the services rendered by such non-resident would be specifically characterised as "work" for the purpose of Section 194C. Therefore, it will not be appropriate to treat it as FTS under Section 9(1)(vii) of the Act.

4. Accordingly, if the services were characterised as "contact work" under Section 194C of the Act, then the income received should be treated as business income. The non-resident company did not have PE in India. Also, the services were rendered and utilised outside India and the payments for the services rendered was also received outside India. Hence, there was no business connection in India and thus the income of the non-resident company was not taxable in India.

VI. India-Singapore DTAA – Even if the services rendered by the non-resident is in the nature of supervision but when the supervisory role requires special skill, knowledge or expertise,

then it will become managerial. Such services are also consultancy services – However, since there was no material to support that the technical knowledge, expertise, skill/know-how or process is made available to the applicant by enabling it to apply the technology independently the same cannot be taxed under Article 12(4) of the DTAA.

Endemol India Private Limited [AAR No. 1076 of 2011 Order dated 6th December, 2013]

Facts

1. The applicant, Endemol India Private Limited, a resident company incorporated under the Companies Act, 1956 was engaged in the business of providing and distributing television programmes.

2. During the financial year 2010-11 the applicant had produced the reality show Khatron Ke Khiladi – Series 3 ("the show") which was aired on Colors Channel. As per the format of the show, the shooting was to take place outside India (primarily Brazil). For the purpose of shooting the show outside India, the applicant engaged Noise Associates Private Ltd. ("NAPL"), a Singapore company, to procure the services of Ms. Chantal Prud' Homme as an executive producer for the show.

3. Under the agreement, NAPL was responsible for the overall production and also for handling business issues. The agreement also provided that NAPL will provide specialised services to Endemol to aid in the production of applicant show programmes for which NAPL agreed to commission its representative to Ms. Chantal Prud' Homme who was an executive producer for the applicant shows/programmes.

4. The applicant sought an advance ruling on the taxability of the payments made to NAPL under the agreement.

Ruling

1. The Hon'ble AAR observed that the agreement clearly stated that NAPL will provide specialised services to applicant to aid in the production of applicant's shows /programmes for which NAPL agreed to commission its representative Ms. Chantal Prud' Homme as an executive producer of the show. The services may be in the nature of supervision as contended by the applicant but when the supervisory role requires special skill, knowledge or expertise, then it will become managerial. A person cannot do the job of supervision of the shows and programmes undertaken by the applicant without having technical knowledge or expertise. The nature of the role played by Ms. Chantal Prud' Homme also fits in with consultancy services as submitted by the Department. Thus the services provided by the NAPL through Ms. Chantal Prud' Homme, therefore was covered by the definition of Fees for technical services ("FTS").

2. It further observed that there was no material to support that the technical knowledge, expertise, skill/know-how or process is made available to the applicant by enabling it to apply the technology independently. Thus, none of the conditions in (a)(b)(c) of the Article 12 (4) of the India-Singapore Double Taxation Avoidance Agreement ("the DTAA") was fulfilled and thus the same was not taxable under the DTAA.

3. It further held that there was nothing on record to show that NAPL had a PE in India and thus in the absence of PE the profits arising out of the transactions for services rendered by NAPL were not taxable in India under Article 7 of the DTAA.

B] HIGH COURT JUDGMENTS

VII. Section 40(a)(i) not applicable on salary of foreign crew reimbursed to service provider as the payment was not royalty or FTS but salary –

Foreign crew also eligible for short stay exemption under Section 10(6)(viii) and hence, salary payment not liable to TDS under Section 192.

DIT vs. Dolphin Drilling Ltd. [Income Tax Appeal No. 38 of 2009 Order dated 19th December, 2013]

Facts

1. The assessee, Dolphin Drilling Ltd., entered into a contract with Alfa Crew, pursuant to which it provided crew services to the assessee. The assessee engaged all such crew as its own employee.

2. Under the contract, Alfa Crew became entitled to receive from the assessee:

- a fixed fee of U.S. $ 869 per day
- salary of crew to be provided by Alfa Crew in U.S. dollar as per invoices and
- handling charge of 5 per cent on such salary.

3. During AY 2004-05, the assessee paid ` 2.03 crores to Alfa Crew on account of fixed fee and handling charges, on which tax was deducted at source ('TAS') and a sum amounting to ` 26 crores on account of salary payable to crew on which it did not deduct any tax at source.

4. The AO disallowed ` 26 crores u/s. 40(a)(i) holding that the same was part of fees for technical services ("FTS").

5. On appeal, the Hon'ble ITAT concluded that the payment, was in the nature of salary and not technical services and since the entire salary was paid to different people, who were foreigners and who earned those salaries by serving in India for a period of less than 90 days during the relevant assessment year the same was not taxable in view of Section 10(6)(viii) of the Act.

6. Aggrieved, the Revenue filed an appeal before the Hon'ble High Court.

Judgment

1. The Hon'ble High Court observed that the facts upon which the Hon'ble ITAT arrived at the said conclusion, were not being disputed in the appeal. It thus held that if those facts were not disputed, then the one and the only conclusion would be that the payments was for salary and not technical fees.

2. It observed that under Section 192 of the Act, it was obligatory on the part of the assessee to deduct tax, but, as stated in Section 192 of the Act, on the estimated income of the employee. In the instant case, since the employees, being foreigners and they having earned those salaries while working in India during a period less than 90 days, those salaries, in view of Section 10(6)(viii) of the Act, were not income of the employees in India.

3. It further held that the Revenue erred in applying the provisions of Section 40(a)(i) which provides for disallowance on account of non-deduction of tax in respect of royalties or FTS. It referred to Section 40(a)(iii) which provides for disallowance on account of non-deduction of tax on any payment chargeable under the head "Salaries".

4. The Hon'ble High Court held that Section 192 of the Act applies only when there is an income chargeable under the head "Salaries". The payments made by the assessee and the income derived thereby by those, who received the same, was though regarded as salary but never regarded as salary chargeable under this Act, as the same was outside the purview of the provisions of the Income-tax Act by reason of Section 10(6)(viii) of the Act and thus disallowance under Section 40(a) could not be attracted.

VIII. India – Korea DTAA – Tax liability cannot be fastened on the assessee without establishing that it was attributable to tax identity or PE situated in India – Revenue cannot

arbitrarily fix a part of the revenue to the PE of assessee in India.

Samsung Heavy Industries Co. Ltd. vs. DIT [Income Tax Appeal No. 1 of 2012 Order dated 27th December 2013] – Assessment Year : 2007-08

Facts

1. The assessee, a tax resident of Korea, had entered into a contract with ONGC and had earned certain revenues under the contract.

2. The assessee claimed that a part of such revenue was earned by carrying out activities 'within' India which was offered to tax in India against which it claimed deduction of certain expenses. The remaining revenue was claimed to be generated by carrying out activities 'out of India', which was not offered to tax in India.

3. Separately, the assessee had a Project Office ('PO") in Mumbai. However, the AO held that 25% of revenues received for 'outside India' activities, should be taxed in India and passed an order accordingly. On appeal, the same was confirmed by the Hon'ble ITAT.

4. Aggrieved, the assessee filed an appeal before the Hon'ble High Court.

Judgment

1. The Hon'ble High Court noted that the assessee had a tax identity in India and a tax identity outside India and, accordingly its tax liability in India was required to be apportioned. Referring to para 1 of Article 7 of the Double Taxation Avoidance Agreement between India and Korea ("the DTAA"), it observed that the mechanism to be adopted to apportion the same was, however, not provided.

2. The Hon'ble High Court observed that in terms of para 1 of Article 7, the assessee would acquire its tax identity in India only when it carried on business in India through a permanent establishment ("PE") situated in India. By submitting the return of income, the assessee has held out that it is carrying on business in India through a PE situated in India. It thus held that the contention of the assessee, whether the PO of the assessee opened at Mumbai can be, or cannot be said to be a PE within the meaning of the said Agreement is of no consequence.

3. It further observed that the assessee held out that a part of the revenue was received by it for doing certain work in India. It did not contend that even those works were done by or through its Project Office at Mumbai. Also, there was not even a finding that 25 per cent of the gross revenue of the assessee was attributable to the business carried out by the PO. It held in terms of Article 5 of the DTAA, PE means a fixed place of business through which business of an enterprise is wholly or partly carried on. In the instant case, according to the Revenue, the PO of the assessee in Mumbai was the PE through which it carried on business during the relevant assessment year and 25 per cent of the gross receipt was attributable to the said business. Neither the AO, nor the Hon'ble ITAT had made any effort to bring on record any evidence to justify the same.

4. It thus concluded that the tax liability could not be fastened on assessee without establishing that the same was attributable to the tax identity or PE of assessee situated in India. Thus, the Revenue cannot arbitrarily fix a part of the revenue to the PE of assessee in India.

IX. Transfer Pricing – Determination of ALP considering entire FOB value of goods sourced for AE, as profit determining denominator, contrary to TP provisions – Rejection of assessee's TP analysis not warranted as orders of lower authorities do not show how and to what extent Li & Fung India bore significant risk or its AE enjoyed locational advantage.

Li & Fung India Pvt. Ltd. vs. CIT [2013] 40 taxmann.com 300 (Delhi)

Facts

1. The assessee, a wholly owned subsidiary in India of Li & Fung (South Asia) Ltd., Mauritius, was set up as a captive offshore sourcing provider. It entered into an agreement with Li & Fung (Trading), Hong Kong, an associated enterprise, for rendering "sourcing support services" for the supply of high volume and time sensitive consumer goods. The assessee was entitled to receive cost plus a mark up of 5% for the services rendered to the AE.

2. The assessee claimed that it was a low risk captive sourcing service provider performing limited functions with minimal risk. It adopted the TNMM and computed the Profit Level Indicator ("PLI") at operating profit margin/ total cost. Since the operating profit margin at 5.17% exceeded the weighted average operating margin of 26 other comparable companies, the assessee claimed that its remuneration was at arm's length.

3. During the course of assessment, the TPO did not dispute the TNMM or the comparables but held that the assessee ought to have received 5% on the FOB value of the goods sourced through the assessee (i.e., the exports made by the Indian manufacturers to overseas third party customers). He also held that the assessee was a risk bearing entity and an independent entrepreneur and it could not be said that the assessee is a risk-free entity.

4. The DRP upheld the TPO's order though it reduced the mark up to 3% of FOB value of exports. On appeal, the Hon'ble Tribunal upheld the stand of the Revenue.

Judgment

1. The Hon'ble High Court observed that the assessee's compensation model was based on functions performed by it and the operating costs incurred by it and not on the cost of goods sourced from third party vendors in India. It held that to apply the TNMM, the assessee's net profit margin realised from international transactions had to be calculated only with reference to cost incurred by it, and not by any other entity, either third party vendors or the AE. Rule 10B(1)(e) of the Rules does not enable imputation of cost incurred by third parties to compute the assessee's net profit margin for application of the TNMM. Thus, the approach of the TPO in essence imputes notional adjustment / income in the assessee's hands on the basis of a fixed percentage of the FOB value of export made by unrelated party venders which is contrary to provisions of the Act and Rules.

2. It further held that the finding that the assessee assumed substantial risk was not based on any material. The assessee made no investment in the plant, inventory, working capital, etc., nor did it bear the enterprise risk for manufacture and export of garments. It merely rendered support services in relation to the exports which were manufactured independently. Thus, attributing the costs of such third party manufacture when the assessee did not engage in that activity and when those costs were clearly not the assessee's costs, but those of third parties, was clearly impermissible.

3. The Hon'ble High Court also observed that the tax authorities should base their conclusions that the assessee bears "significant" risks on specific facts, and not on vague generalities, such as "significant risk", "functional risk", "enterprise risk", etc. without any material on record to establish such findings. If such findings are warranted, they should be supported by demonstrable reason, based on objective facts and the relative evaluation of their weight and significance.

4. Also, as the TPO did not discard the exercise conducted by the assessee of comparing its operating profit margin with that of the comparable companies, and it was not shown that the profit margin and cost plus model adopted by the assessee was distorted, he could not have proceeded to his own determination and calculations. The TPO must first reject the assessment carried out by the assessee before making further alterations. Where all elements

of a proper TNMM are detailed and disclosed in the assessee's study reports, care should be taken by the tax administrators and authorities to analyse them in detail and then proceed to record reasons why some or all of them are unacceptable.

5. It thus concluded that the Hon'ble Tribunal's order, upholding the determination of 3% margin over the FOB value of the AE's contract, was in error of law.

C) TRIBUNAL DECISIONS

X. Reimbursement of salaries of seconded employees is not in the nature of Fees for Technical Services

Temasek Holdings Advisors (I) P. Ltd. vs. DCIT [2013] 38 taxmann.com 80 (Mumbai - Trib.) – Assessment Years : 2007-08 and 2008-09

Facts of the case

1. The assessee, an Indian company, is a wholly owned subsidiary of Temasek Holding Pte Ltd. (THPL) which is an Asia investment firm based at Singapore.

The assessee renders investment advisory services to THPL which includes identifying and analysing potential investment particulars in India, evaluating political and economic scenario for the investment purpose in India and monitoring and making recommendation to THPL in respect of specified investment in India, specifically for unlisted companies.

2. By virtue of secondment agreement, THPL has seconded two of its employees to the assessee, to assist in rendering of investment advisory services. Further, since the said employees were on the payroll of THPL, the salary of these employees was paid by THPL after deducting taxes.

3. Salient Features of the 'Secondment Agreement' are as follows:

a) Supervision, direction and control of the deputed employees is with the assessee.

b) THPL does not bear any responsibility or risk for the results produced by the work of the deputed employees

c) The salary cost of the deputed employees is borne by the assessee and the cost of the deputed employees is charged back by THPL to the assessee on actual basis without any mark-up.

Agreements between the assessee and THPL are unregistered and, date and place in the agreement has not been mentioned. These agreements are colourable device with an intention to avoid tax liabilities in India. Since these payments have been made, without deducting Tax Deducted at Source (TDS) under Section 195 of the Act, the AO disallowed the expenditure under Section 40(a)(i) of the Act. The CIT(A)/DRP confirmed the order of the A.O.

Decision

1. An agreement between the two parties need not necessarily be registered as there is no provision under the law which provides that such secondment agreement needs to be registered or any approval from the Government of India is required. The signed secondment agreement was duly filed and in which the date has already been mentioned in the operating part of the agreement. Accordingly, the secondment agreement cannot be held to be a colourable device.

2. Even if the relationship between the assessee and the THPL is that of an independent contractor and reimbursement of salary is a contractual payment, there is no requirement to deduct tax since the THPL has paid the salary after withholding of tax under Section 192 of the Act.

3. The assessee was not a beneficiary of the expenditure because the seconded employees have been paid salary by THPL who are working in India for the assessee and the assessee is merely reimbursing the same.

4. By rendering service to THPL, the assessee is earning business income and salary paid is a business expenditure on which tax has already been deducted by THPL since the liability to withhold the tax on salary falls within the purview of Section 192 of the Act. There cannot be a double deduction of tax - once at the time of payment of the salary and again on the reimbursement.

5. The decision of the AAR in the case of *Verizon Data Services Pvt Ltd [2011] 337 ITR 192 (AAR)* is not applicable to the facts of the present case since in that case the seconded employees of US Company were rendering services in India and those services were rendered only through the Indian company. Whereas, in the present case the assessee is rendering service to THPL on a mark-up basis and THPL was not rendering any service in India through the assessee.

6. The decision of *Danfoss Industries Pvt. Ltd. [2004] 268 ITR 1 (AAR)* was not applicable to the facts of the present case. Further, THPL is not rendering any service to the assessee and seconded employees are working for the assessee. Accordingly, managerial or consultancy services were not rendered by THPL either directly or through the seconded employees. Hence, provisions of Section 9(1)(vii) of the Act do not apply.

7. Further, such reimbursement is not taxable under Article 12(4) of the tax treaty since the THPL is neither rendering any services to the assessee nor they are making available any kind of technical knowledge, experience, skill or process to the Indian company.

8. The Service PE would exist only when THPL is rendering services in India through its seconded employees. However, in the present case THPL is not rendering any service to the assessee through seconded employees.

9. Accordingly, on the reimbursement of salary, reimbursement of expenditure, expenditure relating to information technology and business promotion, withholding of tax was not required and therefore, there would be no disallowance under Section 40(a)(i) of the Act.

10. The expenditure relating to seconded employees such as meals, travelling, training, etc, was not liable for TDS under the Act. Further, business promotion expenditure and information technology expenditure are also not liable for TDS since they are neither for technical services nor for any professional services. The Supreme Court's decision in the case of *Kanchanganga Sea Foods Ltd vs. CIT [2010] 325 ITR 540 (SC)* is not applicable to the facts of the present case.

11. In the case of professional fees, the expenditures have been incurred for the purpose of the assessee in India and these payments were made by the THPL which has been reimbursed by the assessee. TDS provisions are attracted to the payment for professional services and it does not make any difference whether the payment was made by THPL and reimbursed by the assessee.

The reader may also refer to the following favourable decisions:

- *Abbey Business Services India Pvt. Ltd. vs. DCIT [2012] 53 SOT 401 (Bang.),*
- *ACIT vs. CMS (I) Operations & Maintenance Co. P. Ltd. [2012] 135 ITD 386 (Chen),*
- *DIT vs. HCL Infosystem Ltd.[2005] 274 ITR 261 (Del.),*
- *HCL Infosystems Ltd. [2002] 76 TTJ 505 (Del.),*
- *Dolphin Drilling Ltd. vs. ACIT [2009] 29 SOT 612 (Del),*
- *Cholamandalam MS General Insurance Co. Ltd. Re [2009] 309 ITR 356 (AAR),*
- *DDIT vs. Tekmark Global Solutions LLC (Tekmark) [2010] 38 SOT 7 (Mum),*
- *IDS Software Solutions (I) P Ltd. vs. ITO [2009] 32 SOT 25 (Bang.)*
- *Marks & Spencer Reliance India P. Ltd. [2013] 38 taxmann.com 190 (Mumbai - Trib.)*

- *ITO vs. Ariba Technologies (I) Pvt. Ltd. [TS-258-ITAT-2012(Bang.)]*
- *ACIT, New Delhi vs. Karlstorz Endoscopy India Pvt Ltd [2010-TII-135-ITAT-DEL-INTL.]*

XI. Marketing, turnkey, e-publishing and quality assurance services provided by a foreign company did not 'make available' technical knowledge, skills, etc. and therefore, charges paid for such services cannot be treated as FTS under the India-USA tax treaty

ACIT vs. TexTech International Private Limited [2012] 27 taxmann.com 190 (Chennai) – Assessment Year : 2007-08

Facts of the case

1. The assessee, an Indian company was engaged in the business of e-publishing. The assessee entered into three types of Agreement with its US based subsidiary, Tex Tech Inc. USA (Tex Tech Inc.), as follows:

- **Marketing Agreement** – To provide support to the customers with regard to billing, collection of such amounts and payment to the assessee. Tex Tech Inc. was required to provide market information as and when required by the assessee.
- **Offshore Development Agreement** – For scanning of manuscripts and uploading it to India and also for notifying the assessee through e-mail. Once the assessee had done the typesetting in India and uploaded it back to Tex Tech Inc., they were to download such formatted pages, print the pages and courier it to the ultimate customers.
- **Overseas Services Agreement** – For e-publishing and preparation of typesetting from manuscripts, printing pages and shipping it back to clients.

2. The assessee filed a tax return wherein it claimed deduction of outsourcing cost paid to Tex Tech Inc. on which tax was not deducted at source.

3. According to the assessee, services provided by Tex Tech Inc. were rendered outside India and it was not chargeable to tax in India. Therefore, withholding of tax was not required under Section 195 of the Income-tax Act, 1961.

4. The AO held that Tex Tech Inc. was rendering technical services and such services falls within the definition of Explanation 2 to Section 9(i)(vii) of the Act. However, since tax was not deducted on such payments, it would be disallowed under Section 40(a)(i) of the Act.

5. The CIT(A) held that payments made by the assessee did not fall within the definition of FTS under the tax treaty and therefore, withholding of tax was not required under Section 195 of the Act. Accordingly, the CIT(A) deleted the disallowance made by the AO.

Decision

1. The definition of FTS under Explanation 2 to Section 9(i)(vii) of the Act and Article 12(4) of the tax treaty is not *pari materia.* The AO had not made any study on Article 12(4) of the tax treaty before fastening on the assessee, the liability to deduct tax at source on the payments effected by it.

2. Services rendered by the Tex Tech Inc can fall under Article 12(4)(b) of the tax treaty if the entity abroad 'makes available' technical knowledge, skill, knowhow or process to the assessee in India; or otherwise, the services rendered by entity abroad should consist of development and transfer of technical plan or technical design.

3. As per the Marketing Agreement, no technical service was involved in marketing services because no technical knowledge or skill or experience was made available to the assessee.

4. As per the Overseas Services Agreement, Tex Tech Inc. had to use its expertise, tools and infrastructure for receiving manuscripts for production of book using its own resource, including servicing the customers and effecting dispatches to customer locations. Since the whole of the work was done by Tex Tech Inc., it could not be said that assessee was receiving any technical knowledge, skill, know-how, etc., from Tex Tech Inc.

5. On a perusal of the scope of the Offshore Development Agreement it is clear that the services would involve technical know-how, but, there was no technical knowledge as such made available to the assessee which will give it an enduring benefit.

6. The Offshore Development Agreement specifies that the assessee had to use the instructions sent by Tex Tech Inc. along with files, for carrying out digitisation services. If such instructions were in the nature of technical knowledge which imbibed in the assessee any technical expertise, which in turn helped it in its e-publication business, such that an enduring benefit was received by it, then such services would fall within the purview of Article 12(4)(b) of the tax treaty.

7. On a interpretation of term 'making available' given by the Karnataka High Court in the case of *CIT & ITO vs. De Beers India Minerals Pvt. Ltd. [2012] 72 DTR 82 (Kar.),* it was clear that except for the work mentioned in the Offshore Development Agreement, there was no technical knowledge or service made available to the assessee in any of the other work.

8. Separate invoices were raised by Tex Tech Inc. to the assessee, based on the three different agreements therefore, three agreements were not a composite one. The scope of work of these agreements shows that different types of services were rendered by Tex Tech Inc.

9. With regard to the Marketing Agreement, and Overseas Services Agreement, no part thereof was having income element which was chargeable to tax in India in view of Article 12(4) of tax treaty. Therefore, the assessee was not liable to deduct tax on these payments.

10. However, for Offshore Development Agreement one of the services rendered could have an element of income chargeable to tax in India, which could make available technical services to the assessee in India. However, this aspect has not been examined by the lower authorities. Therefore, the issue of payments made by the assessee to its subsidiary abroad with regard to Offshore Development Agreement was remitted back to the AO.

XII. Leather testing charges – Whether taxable as Fees for Technical Services under the Act as well as India-Germany tax treaty – Held: Yes; Scope of Exclusion u/s 9(1)(vii)(b) – Disallowance u/s 40(a)(i) – Whether payment was made before the retrospective amendment by the Finance Act, 2010 – could it be disallowed under the Act – Held : No

Metro & Metro vs. ACIT [2013] 39 taxmann.com 26 (Agra - Trib.) Assessment Year : 2008-09

Facts of the case

1. The assessee, a partnership firm, was a manufacturer and exporter of leather goods. The assessee was 100% export oriented unit. The assessee made payments to a German company, in respect of leather testing charges. The assessee did not deduct taxes from these payments.

2. The Assessing Officer (AO) held that testing charges are technical-cum-consultancy services and it is deemed to accrue or arise in India under the Act. Accordingly, the same would be taxable in India under the Act as well as under the tax treaty. However, since the assessee did not deduct the taxes on the same, it would be disallowed under Section 40(a)(i) of the Act.

3. The assessee contended that the provisions of Section 9(1)(vii) of the Act will not apply in the present case because the entire testing process is automated. The provisions of Section 9(1)(vii) of the Act can apply only in respect of such a technical service which involves human skills and interplay. Relying on the decision of *Siemens Ltd. vs. CIT [2013] 142 ITD 1 (Mum.)* it was contended that the leather testing services are rendered with the help of machines and, therefore, the same were not in the nature of technical services under Section 9(1)(vii) of the Act. The human element, even if involved, was not more than that of a rather routine process for making the reports, while the core analysis work was done by the machines.

4. The assessee further contended that a 100% exporter and the source of income arises outside India. Therefore, by the virtue of exception of Section 9(1)(vii)(b) of the Act, the FTS was not taxable.

5. With regards to disallowance u/s 40(a)(i), the assessee contended that the retrospective amendment was made in the Finance Act, 2010. However, the payment to the German company was made before the retrospective amendment and therefore, the assessee cannot be penalised for non deduction of tax. In order to support its contention the assessee relied on decision of *Channel Guide India Ltd. vs. ACIT [2012] 139 ITD 49 (Mum.)* where it was held that the disallowance cannot be made in a situation where the taxability was confirmed as a result of retrospective amendment in the Act.

Decision

1. In the case of *Ashapura Minichem Ltd. vs. ADIT [2010] 131 TTJ 291 (Mum.),* the Tribunal observed that, in order to attract taxability in India, it was not necessary that the services must also be rendered in India. The utilisation of services is enough to attract its taxability in India. Further, the Special Bench Tribunal's decision in the case of *ADIT vs. Clifford Chance [2013] 154 TTJ 537 (Mum.)* covers only the scope of Section 9(1)(i) of the Act and the other segments of Section 9(1) of the Act have not been dealt in the said decision.

2. The Supreme Court in the case of *GVK Industries Ltd. vs. ITO [2011] 332 ITR 130 (SC)* did not hold against the constitutional validity of Section 9(1)(vii) of the Act. Perusal of the said decision indicates that the law enacted by the Parliament has a nexus with India, even if such laws require extra territorial operation. The laws so enacted cannot said to be constitutionally invalid and it is only when the 'laws enacted by the Parliament with respect to extra territorial aspects or causes that have no nexus with India' and such laws 'would be *ultra vires*'.

3. There is a nexus between the taxability of services rendered to residents of a tax jurisdiction with that jurisdiction itself. The Tribunal held that the assessee itself contended that the intention of introducing the source rule was to bring to tax interest, royalty or FTS by way of creating a fiction in Section 9 of the Act, the source rule would mean that irrespective of the *situs* of services, the *situs* of assessee and the *situs* of utilisation of services will determine the tax jurisdiction.

4. Section 9(1)(vii)(b) of the Act has two distinct segments i.e. (i) in respect of services utilised in a business or profession carried on by Indian resident outside India, and (ii) in respect of services utilised in respect of earning any income from a source outside India.

5. No doubt whether an India based business is 100% export oriented unit or not, it is still a business carried on in India, and it cannot be covered by the first limb of exception envisaged in Section 9(1)(vii)(b) of the Act.

6. Even if entire products are sold outside India, the fact of such export sales by itself does not make business having been carried outside India. Once the business is set up and carried on in India, irrespective of where the

end consumers are, the business is carried on in India.

7. The scope of second limb of this exception is rather narrow. In order to be covered by this exception, what is material is that, irrespective of where the business was situated, the services need to be used for earning income from any source outside India. A business outside India and a source outside India are used together in contrast, and can be viewed as reflecting relatively active and passive activities. The source of income, whether customers are inside India or outside India, continues to be business in India.

8. The services were required because of the foreign importers and that aspect itself was not decisive and sufficient for the purpose of exclusion from the scope of Section 9(1)(vii) of the Act. The services should be for the purpose of earning an income from a source outside India. A customer is not the source of income, he is an important part of the business, which, in turn, is the source of income.

9. In the case of *Havells India Pvt Ltd vs. ACIT [2011] 140 TTJ 283 (Del.)* not only the customers but also certain manufacturing facilities were located outside India. Once the manufacturing facilities are outside India and the customers are also outside India, such a situation will indeed be covered by the exception of Section 9(1)(vii)(b) of the Act.

10. Just because the user of services is a 100% export unit, it cannot be said that the technical services are used 'for the purpose of making or earning any income from any source outside India', and accordingly, outside the ambit of FTS under Section 9(1)(vii) of the Act.

11. In view of above discussion, the payments made to a German company were taxable in India and, it cannot be said that the assessee did not have obligation to withhold taxes from the remittances made to German company.

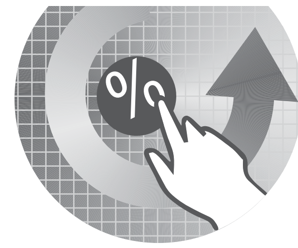
12. Section 40(a)(i) of the Act debars the deduction of 'any interest, royalty, FTS or other sum chargeable under the Act, which is payable outside India, on which tax has not been paid or deducted.

13. The provisions of Section 40(a)(i) of the Act cannot be interpreted in such a manner so as to restrict the scope of section to only amounts remaining payable at the end of the year. Such an interpretation will make the section redundant.

14. In the case of *Channel Guide India Ltd. vs. ACIT [2012] 139 ITD 49 (Mum.),* the Tribunal has observed that the amount paid to the foreign entity was not taxable in India in view of the legal position prevailed during the period of time and it cannot be disallowed under the Act. In the present case also the taxability arises on account of amendment made by the Finance Act, 2010 in Section 9(1) of the Act. Accordingly, following the decision of Channel Guide, the Tribunal held that the disallowance under Section 40(a)(i) of the Act cannot be invoked.

It is never too late to begin creating the bodies we want instead of the ones we mistakenly assume we are stuck with."

— *Deepak Chopra*



CA. Hasmukh Kamdar

INDIRECT TAXES

Central Excise and Customs – Case Law Update

Amendment for registration requirement

The Central Government has amended the Central Excise Rules, 2002 in the following manner. These amendments would become operational with effect from 1-3-2014.

Rule 9(1) at present reads –

(1) Every person who, produces, manufactures, carries on trade, holds private store-room or warehouse or otherwise uses excisable goods, shall get registered;

The proposed amendment would result in the following –

(1) Every person who produces, manufactures, carries on trade, holds private store-room or warehouse or otherwise uses excisable goods or an importer who issues an invoice on which CENVAT Credit can be taken, shall get registered;

As per Rule 9(a)(ii) of the CENVAT Credit Rules, 2004 an invoice issued by an importer is a valid document for taking credit but there was no specific provision requiring an importer to get registered under the Central Excise Act, The diverse practices were followed in different Excise Commissionerates. Now a specific provision is inserted in Rule 9(1) of the Central Excise Rules, 2002 requiring an importer who issues Cenvatable invoice to get compulsorily registered.

Amendment in definition of, "First Stage Dealer"

Rule 2, clause IJ of CENVAT Credit Rules, 2004 is amended in the following manner

The 'First Stage Dealer' is now defined as –

i. A dealer who purchases the goods directly from the manufacturer under the cover of an invoice issued in terms of the provisions of Central Excise Rules, 2002 or from the depot of the said manufacturer , or from premises of the consignment agent of the said manufacturer or from any other premises from where the goods are sold by or on behalf of the said manufacturer or, under the cover of an invoice; or

ii. An importer who sells goods imported by him under the cover of an invoice on which CENVAT credit may be taken and such invoice shall include an invoice issued from his depot or premises of his consignment agent.

The effect of the amendment is that an importer issuing the Cenvatable invoice will now be considered as First Stage Dealer in addition to a dealer purchasing goods directly from the manufacturer.

In terms of Rule 2(s) of the CENVAT Credit Rules, 2004, "Second stage dealer", means a dealer who purchases goods from the first stage dealer;

It therefore follows that a dealer purchasing goods from importer will now be considered as second stage dealer.

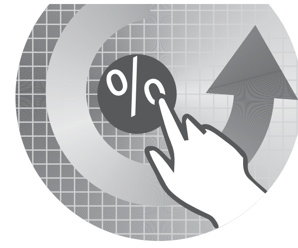
Amendment in prescribed documents for availing CENVAT Credit

In view of the fact that an invoice issued by an importer will be an invoice issued by a first stage dealer, as a consequential amendment , clauses (ii) and (iii) of Rule 9 of the CCR, 2004, prescribing an invoice issued by an importer or from importer's registered depot are omitted as no longer required.

Conclusion

An importer issuing Cenvatable invoice has to obtain Registration under Central Excise before 1-3-2004, unless he is already registered.

An importer will be considered as First stage dealer therefore an invoice issued by an importer will be considered as invoice issued by First stage dealer.



CA Janak Vaghani

INDIRECT TAXES
VAT Update

1. Amendment to Rate of Tax

A) Change in Taxation of Wine

i) Notification No. VAT.1513/CR-150/Taxation-1, dated 24-12-2013

ii) Notification No. VAT.1513/CR-151/Taxation-1, dated 24-12-2013

iii) Notification No.VAT. 1513/CR -106/Taxation-1, dated 24-12-2013/2013

The Government of Maharashtra has issued above notifications to provide changes in rate of tax on sale of wine by amending Schedule D of the Act, rule 54 of the MVAT Rules and grant of exemption u/s 41(5) of the Act respectively from 1-1-2014. The effect of above notifications is explained hereunder:-

Sr. No.	Class of Dealers	Class of Sales	Effective Rate of Tax	Condition
1	Manufacturer/ wholesaler	Sale of wine which is manufactured or imported in India or dispatched to him from out side the State	MRP* 20/120	Dealer should be registered and should mention MRP in sale bill.
2	Wholesaler or Retailer	Sale of wine which is purchased from the registered dealer on or after 1-1-2014	NIL	Dealer should be registered and tax if any payable on corresponding purchase is paid.
3	Wholesaler or Retailer	Sale of wine which is held in closing stock as on 31-12-2013	MRP* 20/120	Dealer should be registered ,the wholesaler should mention MRP in sale bill and both are eligible to claim set-off of tax paid on purchase of wine and packing material on or before 31-12-2013 subject to filing of stock statement in prescribed form on or before 31-1-2014

4	Restaurants and Hotels having gradation of Four star and above	Sale of wine which is purchased from the registered dealer on or after 1-1-2014	20% of actual sales price	Dealer should be registered and tax if any payable on corresponding purchase is paid.
5	Restaurants and Hotels having gradation of Four star and above	Sale of wine which is imported in India or dispatched to him from out side the State	MRP* 20/120 and 20% of actual sales price	Dealer should be registered.
6	Restaurants and Hotels having gradation of Four star and above	Sale of wine which is held in closing stock as on 31-12-2013	MRP* 20/120 and 20% of actual sales price	Dealer should be registered and is eligible to claim set-off of tax paid on purchase of wine and packing material on or before 31-12-2013 subject to filing of stock statement in prescribed form on or before 31-1-2014
7	Restaurants and Hotels having gradation of Three star and below; Clubs	Sale of wine which is purchased from the registered dealer on or after 1-1-2014	5% of actual sales price	Dealer should be registered and tax if any payable on corresponding purchase is paid.
8	Restaurants and Hotels having gradation of Three star and below, Clubs	Sale of wine which is imported in India or dispatched to him from out side the State	MRP* 20/120 and 5% of actual sales price	Dealer should be registered.
9	Restaurants and Hotels having gradation of Three star and below, Clubs	Sale of wine which is held in closing stock as on 31-12-2013	MRP* 20/120 and 5% of actual sales price	Dealer should be registered and is eligible to claim set-off of tax paid on purchase of wine and packing material on or before 31-12-2013 subject to filing of stock statement in prescribed form on or before 31-1-2014
10	Any dealer	Sale of wine in bulk where provisions of Potable Liquor(Fixation of MRP) Rules,1996 does not apply	20% of actual price	
11	Any Dealer	Sale of wine not covered by above	40%	

B) Sale of Motor Vehicles for Handicapped Persons – Schedule A-63

Notification No.VAT.1513/CR-130/Taxation-1, dated 27-12-2013

The Government of Maharashtra has issued above notification to amend Schedule A of the Act whereby new entry 63 is inserted to provide exemption from payment of tax on sale of motor vehicles having engine capacity up to 200 cc, adapted or modified for use by handicapped persons.

The said motor vehicle should be certified as "Invalid carriage" in the certificate of registration issued under the Motor Vehicles Act, 1988 and the selling dealer should retain a copy of such certificate.

2. Exemption from Payment of Late Fees for Filing of Late Returns – Section 20(6)

Notification No.VAT.1513/CR-124/Taxation-1, dated 1-1-2014

The Government of Maharashtra, in exercise of power conferred under proviso to section 20(6) of the Act, has issued above notification to exempt from payment of late fees payable upon late filing of returns by the specified dealer in specified circumstances and specified in Schedule appended thereto. This notification is made effective from 1-8-2012.As per the note in schedule in case of dealers, who have earlier paid the late fee or have adjusted the late fee against the refund for any of the returns, as the case may be covered by this notification, then refund or adjustment of such amount shall not be permitted.

3. Amendment to MVAT Rules – Rule 58

Notification No. VAT 1513/CR-147/Taxation-1, dated 29-1-2014

The Government of Maharashtra, in exercise of power conferred u/s 83(4) of the MVAT Act, has issued above notification to amend rule 58 from 20-6-2006 to determine sale price of goods involved in execution of works contract to give effect to the SC judgment in case MCHI. The gist of amendment to rule 58 is as under:-

i) The Note below the TABLE in sub rule (1) is amended to clarify that deduction for labour specified in sub rule (1) shall be made from total contract value after deducting cost of land determined under sub rule (1A).

ii) In sub-rule (1A) providing for cost of land new proviso is added. Accordingly, after paying tax on the value of goods determined as per rule 58, it is open for the dealer to prove before the Department of Town Planning and Valuation that the actual cost of land is higher than that determined in accordance with the Annual Statement of Rules (including guidelines) prepared under the provisions of the Bombay Stamp (Determination of True Market Value of Property) Rules,1995.Upon proving this ,such actual cost of land will be deducted and excess paid tax if any, shall be refunded.

iii) New sub-rule (1B) is inserted in rule 58.Accordingly, it is provided to determine the value of goods sold, from total contract value after deduction of cost of land and labour as per sub rule (1A) and (1),in case of any dealer undertaking construction of flats, dwellings, buildings or premises and transfers them in pursuance of agreement along with land or interest underlying the land, after applying percentage provided in TABLE depending upon the stage at which the purchaser entered in to contract.

As per TABLE the value of goods sold will be determined after deducting land and labour from total contract value, as under:-

Sr. No.	Stage during which the developer enters in to a Contract With The Purchaser	Amount to be determined as value of goods involved in Works Contract
a)	Before the issue of the commencement certificate	100%
b)	From the commencement certificate to the completion of plinth level	95%
c)	After the completion of plinth level to the completion of 100% RCC framework	85%
d)	After the completion of 100% RCC framework to the Occupancy Certificate	55%
e)	After the Occupancy Certificate	NIL

Under clause (b) to sub-rule (1B) it is provided that for the determination of value of goods sold as per TABLE, it is necessary for the dealer to furnish a certificate from the Local or Planning Authority certifying the date of completion of the stages referred in TABLE. Where such authority does not have a procedure for providing such certificate then such certificate from a registered RCC consultant can be furnished by the dealer.

New sub-rule (1C) is inserted to provide that if the dealer fails to establish the stage during which the agreement with the purchaser is entered then the entire value of goods as determined after deductions of cost of land and labour under sub-rules (1A) and (1) from value of entire contract, shall be taxable.

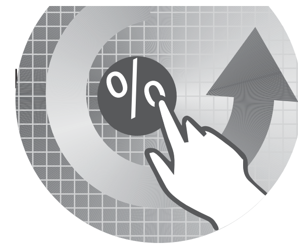
4) Invitation of suggestions for Modifications /Changes/Amendments in procedures, Rules and Acts governed by the Sales Tax Department in view of revamping of automation System of the Sales Tax Department

Trade Circular No. 5T of 2014, dated 6-2-2014

The Commissioner of Sales Tax by above referred Trade Circular has invited tax payers, consultants and employees of department for suggestions to reduce the physical interface with the tax payers by providing hassle free services, implementation of Sales Tax law through the most modern means of automation and causing verifications only in respect of appropriately selected tax payers. The System Integrated is likely to start working from March, 2014 it is appealed to send suggestions latest by 20-12-2014 on following email id:-

"Suggestions 2014@mahavat.gov.in".

> To insure good health: eat lightly, breathe deeply, live moderately, cultivate cheerfulness, and maintain an interest in life.
>
> — *William Londen*



CA. Rajkamal Shah & CA. Naresh Sheth

INDIRECT TAXES
Service Tax – Statute Update

1. Service by way of sponsorship of sporting events – Exemption under NN 25/2012 – ST

In Clause 11(a) the exemption is provided to services by way of sponsorship of sporting events organised by a National Sports Federation, or its affiliated federations, where the participating teams or individuals represent any district, state or zone. The same is now extended to the participating teams or individuals representing the country also.

(NN. 1/2014 – ST dated 10-1-2014)

2. Meaning of Governmental Authority

The meaning of "Governmental Authority" is now widened by replacing the definition in paragraph 2(s) of NN. 25/2012 – ST wherein any authority or a board or any other body with 90% of or more participation by way of equity control, set up by an Act of Parliament or a State legislature or Government to carry out any function entrusted to a municipality under Article 243W of the Constitution would be covered under the definition.

(NN. 2/2014 – ST dated 30-1-2014)

3. Clarification regarding issue of discharge certificate under VCES and availment of CENVAT credit

As regards to availment of Cenvat credit of tax dues paid under VCES, it has been clarified that the declarant shall be eligible only after making full payment and obtaining discharge certificate under section 107(7) and not upon making part payment of tax dues. It has been clarified that the acknowledgement of discharge shall be issued within the seven working days from the date of furnishing of details of payment of tax dues in full along with interest, if any. The Chief Commissioners are advised that the discharge certificate should be issued promptly and not later than the stipulated period of seven working days from the date of tax dues in full along with interest, if any.

It has been reiterated that the eligibility of CENVAT credit shall be governed by the CENVAT Credit Rules, 2004 as already clarified in answer to question No. 22 of FAQ issued by CBEC dtd. 8-8-2013

(Circular No. 176/2014 – ST dated 20-1-2014)

4. Clarification on exemption to Residential Welfare Association

The Central Board of Excise and Customs (CBEC) has issued a circular on levy of service

tax on service provided by a Residential Welfare Association (RWA). According to the circular, if contribution exceeds ` 5000/- per member per month for sourcing goods or services from third person for common use of members of RWA, no exemption would be allowed and service tax would be payable on the aggregate amount on the monthly contribution of such members. However, the basic exemption of ` 10 Lakhs for service provided by RWA as per Notification No. 30/2012 – ST would be available. The aggregate value would not include the value of services exempt from service tax. Whenever RWA provides service as pure agent like in case of electricity, water charges for which the bill is raised by the utility service provider in the name of the apartment owner for consumption therein, the same would be excluded from the value of taxable service if the same is collected without charging any commission or consideration. In case of electricity, water charges for common use in the common area no exclusion is allowable. Further, CENVAT credit may be availed by RWA for use of common services in accordance with CENVAT Credit Rules.

Circular No (175 /01/2014 - ST, dated January 10, 2014)

5. TDS not to be deducted on service tax component

The Central Board of Direct Taxes has issued a circular to the effect that that wherever in terms of the agreement/contract between the payer and the payee, the service tax component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source under Chapter XVII-B of the Act on the amount paid/payable without including such service tax component.

(Income Tax Circular No. 1/2014, dated 13-1-2014)

"True discipline is really just self-remembering; no forcing or fighting is necessary."

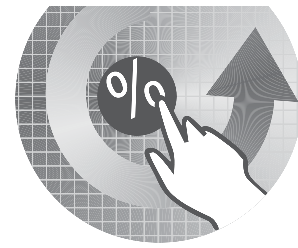
— Charles Eisenstein

The way you think, the way you behave, the way you eat, can influence your life by 30 to 50 years.

— Deepak Chopra

A healthy outside starts from the inside.

— Robert Urich



CA. Bharat Shemlani

INDIRECT TAXES

Service Tax – Case Law Update

1. Services

Clearing and Forwarding Agency Service

1.1 CCE, Salem vs. Salem Starch & Mfrs. Service Indl. Co-op. Society Ltd. 2014 (33) STR 16 (Mad.)

The assessee in this case a co-operative society formed for improvement of tapioca and sago, starch industry and economic condition of cultivators. The owners/principals brought consignment for sale to society's premises for auction. After sale, goods were delivered to buyer at sales premises itself by owner/principal. Society prepared invoices on behalf of principal, for amount paid to them for storage, testing charges and other handling charges and they have also maintained records on receipt of the amount and the stock received and available after the sale. The High Court after observing facts held that, society was not doing forwarding service. Handling goods on receipt raising invoices on sale or maintaining of records as to stock availability, at the best, showed Society only as agency offering storage facility, which could not convert the transaction as that of C&F Agent. Incidental services offered in transaction in arranging transportation of goods to buyer could not decide the nature of transaction. Further, department itself was not certain about head under which transaction would fall and it attempted to hit at some clause to bring society somehow within the net of taxation.

1.2 Swagat Freight Carriers Pvt. Ltd. vs. CST, Mumbai 2014 (33) STR 81 (Tri.-Mumbai)

The Tribunal in this case after relying on decision in *Gudwin Logistics 2012 (26) STR 443 (Tri.-Ahmd), Larsen & Toubro 2006 (3) STR 321 (Tri.-LB) etc.* held that Freight Forwarders is distinct and different from Clearing & Forwarding Agency service.

Business Auxiliary Service

1.3 Interplex Electronics India P. Ltd. vs. CST, Bengaluru 2014 (33) STR 56 (Tri.-Bang.)

The Tribunal in this case held that elctropating of goods on job work with silver or gold amounts to manufacture hence appellant is not liable to pay service tax in view of specific exclusion in the definition of BAS. Further, the appellant has supplied goods to 100% EOU, who are eligible for exemption under Notification No. 24/2003-CE and since the said exemption is not an unconditional exemption the appellant has a case for elgibility for exemption under Notification No. 8/2005-ST also even if it is assumed that the process does not amount to manufacture.

1.4 Krishan Kumar vs. CCE, Chandigarh 2014 (33) STR 60 (Tri.-Del.)

The appellant in this case being contractors running the retail outlet for petroleum products of IBP/IOC and incurred expenses like Tea/Coffee/Consumables, salary of employees,

handling losses of generator set, bank charges, electricity charges, etc. and claimed reimbursement of such expenses without levying service tax. The Tribunal held that, as per section 67 of FA, 1994 value of any taxable service is gross amount charged by service provider and it does not provide for any deduction therefrom. It is further held that, extended period of limitation is invocable as the assessee has neither paid service tax nor filed any ST-3 returns.

1.5 KPIT Cummins Infosystems Ltd. vs. CCE, Pune-I 2014 (33) STR 105 (Tri.-Mumbai)

The assessee provided software development and consultancy services through branches located abroad to overseas customers. They received proceeds for the same after deducting expenditure by branches. The Tribunal held that, *prima facie* provisions of section 66A of FA, 1994 are not attracted as consumption of services abroad and therefore question of subjecting activity to tax in India is unsustainable in law. Further, said services amounts to export of services under rule 3 of ESR, 2005 and not liable to service tax.

Marketing and Sale Support Service

1.6 Tandus Flooring India Pvt. Ltd. vs. CST, Bengaluru 2014 (33) STR 33 (AAR)

The applicant involved in promotion and marketing of products of Tandus US and Tandus China in India. The Authority held that, place of provision of service to be determined by rule 3 of POPs Rules, 2012, which is location of service recipient namely Tandus US and Tandus China. Further, the service provided is not figured in section 66D of FA, 1994, place of provision of service is outside India, payment is received in CFE and applicant and service recipient both are independent entities, therefore provision of rule 6A of STR, 1994 have been satisfied and services qualifies as export of service.

Consulting Engineer Service

1.7 Suzlon Windfarm Services Ltd. vs. CCE, Pune-II 2014 (33) STR 65 (Tri.-Mumbai)

The appellant in this case provided services of operation, maintenance and security of windmills sold by their clients to customers. The department sought to tax them under Consulting Engineers Service. The Tribunal held that, no advice, consultancy and technical assistance in any field of engineering is rendered and executionary services are not covered under Consulting Engineers Service. The ratio of Rolls Royce Industrial Power (I) Ltd. 2006 (3) STR 292 (T) is relevant and squarely applicable to the present case.

1.8 CST, Mumbai vs. Leibert Corporation 2014 (33) STR 161 (Tri.-Mumbai)

The Tribunal in this case held that, supply of technical know-how, licence, patents, trade secrets, process for manufacture of licensed products and consideration received thereof is not liable to service tax under Consulting Engineers Service as no advice, consultancy or technical assistance has been given.

1.9 CST, Mumbai vs. Fugro Geonics Pvt. Ltd. 2014 (33) STR 170 (Tri.-Mumbai)

The assessee in this case carried out positioning service, hydrographic survey, oceanographic survey, seismic survey, geophysical and geotechnical survey and engineering survey in connection with oil exploratory operations to be carried out by the client. The Tribunal held that since, no service relating to advice, consultancy or technical assistance has been given and the service merits classification under Survey and Exploration of Minerals Service. It is also held that, when activity covered under specific entry, which came later, service tax not to be demanded on same activity under different category for prior period.

Commercial or Industrial Construction Service

1.10 B. G. Shirke Construction Technology Pvt. Ltd. vs. CCE, Pune-III 2014 (33) STR 77 (Tri.-Mumbai)

The appellant in this case constructed a sports complex including Stadium, where the said

Stadium was allowed to be used by public on payment of user charges. The Tribunal held that, Stadium is a public facility for recreation of public and merely because some amount is charged for usage, Stadium does not become commercial or industrial construction. Sport stadium is non-commercial construction therefore, not liable to service tax.

Erection, Commissioning and Installation Service

1.11 CST, Mumbai vs. Hyundai Heavy Industries Co. Ltd. 2014 (33) STR 111 (Tri.-Mumbai)

The Tribunal in this case held that, pipes or pipelines are not plant, machinery or equipment and the said activity is not liable to tax under ECI Service. Further, the laying of pipelines is specifically covered under Commercial or Industrial Construction Service.

Maintenance and Repair Service

1.12 Ketan Motors Ltd. vs. CC, CE &ST, Nagpur 2014 (33) STR 165 (Tri.-Mumbai)

The department in this case, sought to include value of spare parts sold in taxable value of service. The Tribunal held that, confirmation of demand on basis of value of spare parts as reflected in balance sheet is incorrect and question of levy of service tax does not arise where transaction involves sale of spare parts. Payment of VAT/Sales tax on transaction indicating transaction to be treated as sale of goods and hence matter remanded back for fresh consideration.

2. Interest/Penalties/Others

2.1 R. V. Man Power Solution vs. CC&CE 2014 (33) STR 23 (Uttarakhand)

The High Court in this case held that, amount mentioned in show cause notice is merely a demand and not even the tentative adjudication. Under section 87 of FA, 1994 any amount payable means that amount adjudged after hearing the show cause notice and section 87 is one of the methods of recovery of amount due and payable after adjudication is done. The order in appeal freezing the Bank accounts is not sustainable in the eye of law having been passed without any jurisdiction.

2.2 CCE, Ludhiana vs. Amarjit Aggarwal & Co. 2014 (33) STR 59 (Tri.-Del.)

The department in this case denied benefit of exemption under Notification No. 6/2005-ST while determined value of Works Contract Service without excluding value of goods sold. The Tribunal held that, once value of goods sold excluded from value of works contract, taxable service falls below ` 4 lakhs for financial year entitling taxpayer to the benefit of Notification No. 6/2005-ST as small service provider.

2.3 ITC Ltd. vs. CST, Delhi 2014 (33) STR 67 (Tri.-Del.)

The SCN issued to the appellant failed to specify specific clause under which activity falling nor activity characterised with reference to distinct attributes of any clause. The Tribunal held that, unless assessee put to notice, no opportunity to assessee to meet case against him. There is no scope for assuming ground implicit in issuance of SCN. Reason for issuance of SCN on the basis of *prima facie* assumption that assessee assessable to levy of Service tax for providing BAS not specified. Mere extraction of entire provision under section 65(19) of FA, 1994 not fulfils requirement. SCN is invalid, infirmity incurable and therefore quashed.

2.4 Zaheerkhan B. Khan 2014 (33) STR 75 (Tri.-Mumbai)

In this case, the appellant provided promotion services however, tax liability thereon has been discharged by agent. The Tribunal observed that, agents appointed for negotiating with corporate and discharge of tax liability and in view of section 65(7) of FA, 1994 assessee means person liable to pay Service Tax and includes his agent and therefore discharge of tax liability by agent is sufficient compliance of law.

2.5 CST, Chennai vs. Sangmitra Services Agency 2014 (33) STR137 (Mad)

The department in this case contended that, reimbursable expenses received by assessee to be added to the taxable value related to clearing and forwarding agent service. The High Court held that, in absence of any material to show the understanding between the principal and the client the commission payable by principal was all inclusive and it is difficult to hold that the gross amount of remuneration/commission would nevertheless include expenditure incurred by assessee providing the services. Thus, if a receipt is for reimbursing the expenditure incurred for the purpose, the mere act of reimbursement, *per se*, would not justify the contention of Revenue that same, having the character of the remuneration or commission deserves to be included in the sum amount of remuneration/commission.

3. CENVAT Credit

3.1 Hindustan Zinc Ltd. vs. CCE, Jaipur-II 2014 (33) STR 71 (Tri.-Del.)

The Tribunal in this case held that, dismantling/handling and transportation of unusable material used for renovation and repair of factory machinery is covered under definition of Input Service and credit thereon is admissible.

3.2 KPMG vs. CCE, New Delhi 2014 (33) STR 96 (Tri.-Del.)

The appellant in this case providing Management Consultancy services, availed credit in respect of Management, Maintenance or Repair service, employee mediclaim insurance, car hire, car parking service for which department objected for. The Tribunal held that, department's contention of functional utility and integral nexus of input to final product to be considered for entitlement of CENVAT credit, does not merit acceptance. Input and Input Service definition are distinct under CCR, 2004. Input service is defined illustratively, not restrictively; illustratively and not exhaustively as comprising *inter alia* the enumerating service. Expression 'in relation to' in the definition of Input service signifies broad expression indicating comprehensiveness having direct and indirect significance depending on context and expression 'includes' signifies an inclusive definition and meaning, is illustrative and not exhaustive.

It is further held that, on fair construction of definition of Input Service, any service used by provider of taxable service for providing output service including services used in relation to setting up, modernization, renovation or repairs of premises, procurement of inputs, activity relating to business to constitute input service.

3.3 CCE, Salem vs. Cheran Spinners Ltd. 2014 (33) STR 148 (Mad.)

The assessee in this case discharged service tax liability on GTA service through CENVAT credit. The department objected to such adjustment. The High Court after going through rules 2(l) and (p) of CCR, 2004 held that in payment of service tax liability by recipient of taxable service, such assessee are also entitled to make use of CENVAT credit to discharge their liability under Service Tax provisions.

3.4 Stovec Industries Limited vs. CCE, Ahmedabad 2014 (33) STR 155 (Tri.–Ahmd)

The Tribunal in this case allowed CENVAT credit of service tax paid on CHA services availed at port for export of goods. It is further held that, Commissioner (Appeals) is a departmental officer and is bound by Circular issued by Board.

3.5 Crossword Agro Industries vs. CCE, Rajkot 2014 (33) STR 185 (Tri.-Ahmd.)

The Tribunal in this case held that, CENVAT credit is not admissible on the services used with respect to traded goods when utilized only for export of such traded items, which were not used in the stream of manufacture.

Janak C. Pandya, *Company Secretary*

CORPORATE LAWS
Company Law Update

Case Law No.1

[2013] 181 Comp Cas 417 (Bom.)

[In the Bombay High Court]

Etisalat Mauritius Ltd. vs. Etisalat DB Telecom P. Ltd and Others.

A deadlock, lack of faith and probity resulting in complete breakdown between the main shareholders could be a just and equitable cause under section 433 (e) of the Companies Act, 1956 for filing winding up petition

Brief Facts

Etisalat Mauritius Ltd. ("Petitioner") has filed this winding up petition against Etisalat DB Telecom P. Ltd. ("R1") under the provisions of Companies Act, 1956 ("Act").

The reason for filing this petition is that as per petitioner, it is "just and equitable to wind up the Company on the grounds that (1) due to cancellation of 2G licences by Supreme Court, it has incurred losses. (2) Dysfunctional board of directors due to withdrawal of directors by R2 and (3) Company is insolvent and cannot pay its dues.

R1 Company was originally incorporated in the name of "Swan Telecom P. Ltd." and changed its name to current name Majestic Infracon P. Ltd., a company owned and controlled directly or indirectly by Shahid Balwa and Vinod Goenka. ("R2"). R2 is under investigation for its role in the 2G scam.

R2 had approached the petitioner for investing in R1 and gave all representation and warranties as to validity of license held by R1. Upon investment, petitioner is holding 44.73% of share capital of R1. The Petitioner had claimed that the capital contribution made by them was used by R1 for repayment of bank loans which had been funded for 2G licenses cost.

Petitioner also submits that there was a management services agreement between R1 and Petitioner Group Company for the management of R1 but all management functions were handled by R2 and their directors.

Petitioner has invested additional sum of ` 209.70 crore for acquiring 2 equity shares in R1. The said capital contribution is used for acquiring 2G license for Rajasthan and Haryana. Subsequently, additional sum of ` 106.95 crore invested by the Petitioner for which 1 equity share was allotted to it. Upon filing of Public Interest Litigation as to allocation of 2G spectrum allocation, various actions were taken by CBI upon directions issued by the Supreme Court of India including registering of an FIR for illegal gratification against Group Company of R2. CBI charge sheet claims that R1 was ineligible for obtaining 2G license and that R2 promoters entered into a criminal conspiracy with R-ADAG, a company of Reliance Anil Ambani group to cause the DoT to allot 2G licence to R1.

In 2011, R2 had filed petition before CLB under sections 397 and 398 against R1 and petitioner and

alleged that (1) petitioner failed to bring its expertise and management skills for R1 business, (2) failed to comply with the capital call made by R1 and) (3) petitioner is responsible for the financial losses of R1.

However, said petition was withdrawn by the R2 and claimed that same was filed by his lawyer without their consent or concurrence. Upon cancellation of license, the board of directors has decided to shut down operation and said decision was also supported by director nominated by R2. Another Reliance company had also filed claim of ` 1679 crore against R1. The Petitioner had also filed a civil suit against R2 and its promoters for loss of investment due to fraudulent representation and misrepresentation. Upon another application filed by a bank, the Debts Recovery Tribunal, had passed an ex parte order for attachment of all the assets of R1 and appointed a receiver in respect of the same. Meanwhile, R2 has invoked the arbitration process against the Petitioner under the shareholders agreement, which was denied.

Upon various applications made by Petitioner, R2, employees and creditors of R1 and consented by the parties, the High Court of Bombay appointed an authorised person ("AP") to preserve and protect the assets of R1 and to mitigate and minimise the cost and liabilities.

The two banks have supported the present winding up petition. The main contention of the petitioner is that 2G licence was the only tangible asset of R1 and without it, it has no commercial enterprise. Whereas R2 has submitted that R1 still had another three valid telephone licence for International Long Distance (ILD), National Long Distance (NLD) and Internet Service Provider (ISP). Further, R1 can apply for fresh 2G licence when it already had necessary infrastructure.

In its opposition for winding up petition, R2 has contended various points such as (1) Petitioner has wrongly relied on events post the filing of the petition and relied on judgments in *Seth Mohan Lal vs. Grain Chambers Ltd. [1968] 38 Comp Cas 543 (SC)* and others. (2) Petitioner has not issued statutory notice under section 434(1)(a) in alleged capacity as creditor for substantiating claim under section 433(e) of the Act. (3) Petitioner has provided network equipment as very high cost and not provided management support. (4) Petitioner did not pay call money.

Judgments and Reasoning

The Court admitted the winding up petition. The Court rejected the application by R2 for staying the operation of admission of the Petition. It has also observed that there exists a dead lock between the main shareholders of R1 and lack of faith and probity, resulting in irretrievable breakdown between the major shareholders.

The Court also observed that the R1 has to recover several huge amounts from the statutory authorities as well as banks. R1 also required to answer various show cause notices of regulatory authorities. On objection raised by R2 regarding petition filed under section 433(e) of the Act and that the same required the issuance of notice under section 434(1)(a) of the Act, which was not complied with. The Petitioner's submission as per judgments in *Pandam Tea Co. Ltd. vs. Darjeeling Commercial Co Ltd. [1977] 47 Comp Cas 15 (Cal.), N.N. Valechha vs. I.G. Petrochemicals Ltd. [2008] 143 Comp Cas 122 (Bom.)* was accepted by the Court. Another contention of R2 that since Petitioner had filed a civil suit and thus, selected an alternative remedy, it could not file winding up petition on just and equitable ground was also rejected.

Case Law No. 2

[2014] 182 Comp Cas 13 (AP)

[In the Andhra Pradesh High Court]

Dr. T.H. Chadary vs. Registrar of Companies and Another

A liability for mis-statement in prospectus cannot be attributable, if company did not invest the monies in the manner as promised in the prospectus. The directors will be liable for punishment if the statements in the prospectus are not true and cannot made liable if, the said statements have not been adhered to.

Brief facts

This petition is filed by Dr. T.H. Chadary ('Petitioner") against the complaint made by the Registrar of Companies ("R1") for prosecuting Dr. T. H. Chadary ('Petitioner") for committing offence under section 63, section 68 and section 628 of the Companies Act, 1956.

Petitioner is one of the directors of Sibar Software Services (India) Ltd. ("Company'). The Company had issued prospectus for public issue of 35,00,000 equity shares. The complaints were based on the following allegations.

a. Company had issued prospectus with an object to establish a software centre at Hyderabad and Vijayawada.
b. Invest in Mauritius subsidiaries and other foreign countries for marketing support;
c. To purchase hardware and software;
d. Working capital margin money;
e. Listing of shares on recognised stock exchanges.

Based on the scrutiny of audited balance sheet for the years 2000 to 2003 of the Company, it was observed that no investment in overseas companies was made. The investment made in local company and increased over the period in which one of the directors has special interest. Also, investment was made as intercompany deposits. The Company had not given complete break up of utilisation of funds in the director's report and thus made untrue statements.

Based on the above, as per R1, the statement made in the prospectus are knowingly false, so much, that all the accused including the petitioner are liable for punishment under section 63 ("Criminal Liability" for misstatements in prospectus), section 68 (penalty for fraudulently inducing persons to invest money") and section 628 ("Penalty for false statements") of the Act.

The maximum penalty under section 63 and section 628 is imprisonment up to 2 years, whereas penalty under section 68 is five years.

The submission made by the petitioner for quashing the complaint against the petitioner is as follows.

a. Two of the complaints are barred under section 468(2)(c) of the Code of Criminal Procedure, 1973 ("CrCP") and
b. No specific facts as to alleged criminal activities against the petitioner were made.

It was submitted that for launching prosecution, the time limit was 3 years. The prospectus was issued on December 2, 1999 and the complaint was made on March 10, 2010. Thus, said complaints were barred by limitation.

R1 contended that period of limitation did not commence till the filing of the balance sheet for the year 2006 on October 12, 2007. Thus, filing of complaint is well within time.

Judgments and reasoning

Court allowed the petition and quashed the complaint and consequently the prosecution of petition under sections 63, 68 and 628 of the Companies Act.

Court has reviewed the provisions of section 63 and section 68 of the Act and submission of the Petitioner that no specific allegations were made. Court also observed that under section 63, it is a case of strict liability in the absence of any contrary evidence. It has further observed that section 68 and 628 require *mens rea* as to making statement knowingly or recklessly and that statement should be known to be false. On investment in foreign subsidiaries, it was noted that Cost of Projects and means of cost is appraised by the Bank of Madhura Ltd. and not claimed by the directors and company. The Court looked at the judgment of Kerala High Court in *K. Gopi Nair vs. K Ramukutty [2003] 115 Comp Cas 59 (Ker.)* under section 428 of Cr. PC and noted that if the allegation as set out in the complaint and if it did not reveal any offence, it would be open to court to quash the complaint. Court has also referred to the judgment in *Hemendra Prasad Nag Chowdary vs. Registrar of Companies [2010] 158 Comp Cas 21 (AP); [2010] 1 ALD (Crl.), 1004* where it was held that offence under sections 63, 68 and 628 of the Act have not been made out merely because the prospectus gave an encouraging state of affairs of the company.

CA. Mayur Nayak, CA. Natwar Thakrar &
CA. Pankaj Bhuta

OTHER LAWS
FEMA Update

In this article, we have discussed recent amendments to FEMA through Circulars issued by RBI :

1. Overseas Direct Investments – Rollover of Guarantees

In terms of Regulation 6 of Notification No. FEMA 120/RB-2004 dated July 7, 2004 [Foreign Exchange Management (Transfer or Issue of any Foreign Security) (Amendment) Regulations, 2004] (the Notification), RBI has now decided not to treat/reckon the renewal/rollover of an existing/original guarantee, which is part of the total financial commitment of the Indian party as a fresh financial commitment, provided that :

a) the existing/original guarantee was issued in terms of the then extant/prevailing FEMA guidelines.

b) there is no change in the end use of the guarantee, i.e. the facilities availed by the JV/ WOS/Step Down Subsidiary;

c) there is no change in any of the terms & conditions, including the amount of the guarantee except the validity period;

d) the reporting of the rolled over guarantee would be done as a fresh financial commitment in Part II of Form ODI, as hitherto; and

e) if the Indian party is under investigation by any investigation/enforcement agency or regulatory body, the concerned agency /body would have to be kept informed about the same.

RBI has further clarified that in case, however, the above conditions are not met, the Indian party has to obtain prior approval of the Reserve Bank for rollover/renewal of the existing guarantee through the designated AD bank.

(A.P. (DIR Series) Circular No. 83 dated 3rd January, 2014)

(This will come as a breather to many Indian companies after recent reduction in overall financial commitment from 400% to 100% of net worth under automatic route.)

2. Issue of non-convertible/ redeemable bonus preference shares or debentures – Clarifications

In terms of Regulation 2(ii) and Regulation 5 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 notified *vide* Notification No. FEMA.20/2000-RB dated May 3, 2000, equity shares, compulsorily and mandatorily convertible preference shares and compulsorily and mandatorily convertible

debentures are treated as a part of share capital for the purpose of Foreign Direct Investment.

Hitherto, RBI used to grant permission for issue of non-convertible/redeemable bonus preference shares or debentures to non-resident shareholders from the general reserve under a Scheme of Arrangement by a Court, under the provisions of the Companies Act, as applicable.

Indian companies are now given general permission to issue non-convertible/redeemable preference shares or debentures to non-resident shareholders (including the depositories that act as trustees for the ADR/GDR holders) by way of bonus from its general reserves. However, this general permission is subject to two conditions and they are: (i) issue of such bonus shares/debentures must be in accordance with a Scheme of Arrangement approved by a Court in India under the provisions of the Companies Act, and (ii) obtaining a no-objection from the Income Tax Authorities.

(A.P. (DIR Series) Circular No. 84 dated 6th January, 2014)

(It may be noted that such general permission has been granted only for issuance of bonus preference shares or debentures to non-residents.)

3. External Commercial Borrowings (ECB) Policy – Liberalisation of definition of Infrastructure Sector

In terms of Notification No. FEMA.281/2013-RB dated July 19, 2013 published in the Gazette of India *vide* G.S.R. No. 627 (E) dated September 12, 2013 and to the A.P. (DIR Series) Circular No. 48 dated September 18, 2013, the definition of infrastructure sector for the purpose of raising ECB was expanded by RBI after taking into account the Harmonised Master List of Infrastructure sub-sectors and Institutional Mechanism for its updation as approved by Government of India *vide* Notification F.No. 13/06/2009-INF dated March 27, 2012.

RBI has now decided to include 'Maintenance, Repairs and Overhaul' (MRO) as a part of airport infrastructure for the purpose of ECB. RBI has further clarified that accordingly, only MRO associated with airport infrastructure (as distinct from the related services which are other than infrastructure) will be considered as part of the sub-sector of Airport in the Transport Sector of Infrastructure.

(A.P. (DIR Series) Circular No. 85 dated 6th January, 2014)

4. Foreign Direct Investment – Pricing Guidelines for FDI instruments with optionality clauses

In terms of Regulation 5 (1) of Foreign Exchange Management (Transfer and Issue of Shares by a Person Resident outside India) Regulations, 2000 notified *vide* Notification No. FEMA 20/2000-RB dated May 3, 2000, only equity shares or compulsorily convertible preference shares/compulsorily convertible debentures are eligible to be issued to persons resident outside India under the Foreign Direct Investment Scheme.

RBI has now allowed optionality clauses in equity shares and compulsorily and mandatorily convertible preference shares/debentures to be issued to a person resident outside India under the Foreign Direct Investment (FDI) Scheme. Such optionality clause should oblige the buy-back of securities from the investor at the price prevailing/value determined at the time of exercise of the optionality in order to enable the investor to exit without any assured return. The provision of optionality clause would be subject to the following conditions:

a) There should be a minimum lock-in period of one year or a minimum lock-in period as prescribed under FDI Regulations, whichever is higher (e.g. defence and construction development sector where the lock-in period of three years has been prescribed). The lock-in period should be effective from the date of allotment of

such shares or convertible debentures or as prescribed for defence and construction development sectors, etc. in Annex B to Schedule 1 of extant FEMA Notification No. 20;

b) After the lock-in period, as applicable above, the non-resident investor exercising option/right would be eligible to exit without any assured return, as under:

   (i) In case of a listed company, the non-resident investor would be eligible to exit at the market price prevailing at the recognised stock exchanges;

   (ii) In case of unlisted company, the non-resident investor would be eligible to exit from the investment in equity shares of the investee company at a price not exceeding that arrived at on the basis of Return on Equity (RoE) as per the latest audited balance sheet. Any agreement permitting return linked to equity as above would not be treated as violation of FDI policy/FEMA Regulations. [Note: For the above purpose, RoE shall mean Profit After Tax / Net Worth; Net Worth would include all free reserves and paid-up capital.]

   (iii) Investments in Compulsorily Convertible Debentures (CCDs) and Compulsorily Convertible Preference Shares (CCPS) of an investee company could be transferred at a price worked out as per any internationally accepted pricing methodology at the time of exit duly certified by a Chartered Accountant or a SEBI registered Merchant Banker. RBI has further stated that the guiding principle would be that the non-resident investor is not guaranteed any assured exit price at the time of making such investment/agreement and would exit at the price prevailing at the time of exit, subject to lock-in period requirement, as applicable.

RBI has notified the above changes *vide* Notification No. FEMA. 294/2013-RB dated November 12, 2013 *vide* G.S.R. No. 805(E) dated December 30, 2013.

(A.P. (DIR Series) Circular No. 86 dated 9th January, 2014)

(Post issuance of this circular, RBI has updated the FAQs on Foreign Investments in India to incorporate the change in policy. Analysis and important implications of the change in this policy is presented as below:

- *RBI has clarified in updated FAQs that the* ***entry time pricing guidelines would be the same for FDI with or without optionality (i.e., based on DCF method). But there would be two sets of pricing guidelines at the time of exit of non-resident from FDI. One applicable to plain FDI instruments (i.e., based on DCF method) and another for FDI with optionality clause (i.e., based on ROE).***
- *In FAQ No. 48, RBI has clarified that in case* ***of an unlisted company, the non-resident investor would be able to exit at a price which gives annualised return equal to or less than the RoE as per latest audited balance sheet. For example, ROE based on previous year's audited balance sheet (assuming no audit has been carried out*** *specifically for the purposes of exit) arrives at 15% and assume that the investment had been made five years prior to the time* ***of exit. Therefore, as per this FAQ, the exit price would be calculated as (Cost of Investment + Return @ Compounded*** *Annual Growth Rate of 15% for five years).* ***As a result, the exit price would unduly and unjustly be dependent on the ROE of the previous year, not taking into account the*** *profits/losses made/incurred by the company* ***in the previous year.***

- ***It seems RBI has not envisaged situations of incurrence of loss in the particular year based on which ROE has to be computed, at the time of devising these guidelines.***
- ***These pricing guidelines would make investments in CCDs and CCPS more attractive wherein valuations based on forward looking projections can continue to be adopted.)***

5. Resident bank account maintained by residents in India – Jointholder – Liberalisation

Hitherto, in terms of A.P. (DIR Series) Circular No. 12 dated September 15, 2011, individuals resident in India were permitted to include non-resident close relative(s) (relatives as defined in section 6 of the Companies Act, 1956) as a joint holder(s) in their resident savings bank accounts on "former or survivor" basis. Such non-resident Indian close relatives were however not eligible to operate the account during the life time of the resident account holder in terms of said instructions.

RBI has now decided to allow AD banks to include a NRI close relative (relatives as defined in section 6 of the Companies Act, 1956) in existing/new resident bank accounts as joint holder with the resident account holder on "Either or Survivor" basis subject to the following conditions :

a) Such account would be treated as resident bank account for all purposes and all regulations applicable to a resident bank account would be applicable.

b) Cheques, instruments, remittances, cash, card or any other proceeds belonging to the NRI close relative would not be eligible for credit to this account.

c) The NRI close relative has to operate such account only for and on behalf of the resident for domestic payment and not for creating any beneficial interest for himself.

d) Where the NRI close relative becomes a joint holder with more than one resident in such account, such NRI close relative should be the close relative of all the resident bank account holders.

e) Where due to any eventuality, the non-resident account holder becomes the survivor of such an account, it would be categorised as Non-Resident Ordinary Rupee (NRO) account as per the extant regulations.

f) Onus would be on the non-resident account holder to keep AD bank informed to get the account categorised as NRO account and all such regulations as applicable to NRO account would be applicable.

g) The above joint account holder facility can be extended to all types of resident accounts including savings bank account.

While extending this facility the AD banks have been asked to verify actual need for such a facility and also obtain a declaration duly signed by the non-resident account holder as given in the Circular.

(A.P. (DIR Series) Circular No. 87 dated 9th January, 2014)

(This is a welcome step which will particularly help NRIs having single elderly parents residing in India wherein they would now be able to operate the savings bank accounts online for and on behalf of their parents)

6. Memorandum of Instructions for opening and maintenance of Rupee/ Foreign Currency Vostro Accounts of Non-Resident Exchange Houses

In view of expanding the scope of the Rupee Drawing Arrangements (RDAs), RBI has amended the instructions pertaining to RDAs with Exchange Houses to include additional items under Permitted Transactions under RDAs.

Following three additional transactions have been now permitted under such RDAs:

- Payments to utility service providers in India, for services such as water supply, electricity supply, telephone (except for mobile top-ups), internet, television, etc.
- Tax payments in India
- EMI payments in India to Banks and Non-Banking Financial Companies (NBFCs) for repayment of loans.

(A.P. (DIR Series) Circular No. 88 dated 9th January, 2014)

7. Exim Banks line of credit of USD 42.61 million to the Govt. of the Republic of Benin

The Credit Agreement under the LOC is effective from December 16, 2013 and the date of execution of Agreement is September 6, 2013.

(A.P. (DIR Series) Circular No. 89 dated 9th January, 2014)

8. Provisions under section 6(4) of Foreign Exchange Management Act, 1999 – Clarifications

In terms of section 6(4) of FEMA, 1999, a person resident in India can hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

In response to various representations received by RBI, it has given clarifications on the scope of transactions covered under section 6(4) of FEMA, 1999 to include the following:

a) Foreign currency accounts opened and maintained by such a person when such person was a resident outside India;

b) Income earned through employment or business or vocation outside India taken up or commenced while such person was resident outside India, or from investments made while such person was resident outside India, or from gift or inheritance received while such a person was resident outside India;

c) Foreign exchange including any income arising therefrom, and conversion or replacement or accrual to the same, held outside India by a person resident in India acquired by way of inheritance from a person resident outside India;

d) A person resident in India can freely utilise all their eligible assets abroad as well as income on such assets or sale proceeds thereof received after their return to India for making any payments or to make any fresh investments abroad without approval of Reserve Bank, provided the cost of such investments and/or any subsequent payments received therefor are met exclusively out of funds forming part of eligible assets held by them and the transaction is not in contravention to extant FEMA provisions.

(A.P. (DIR Series) Circular No. 90 dated 9th January, 2014)

(It is a welcome circular from RBI which would mainly benefit the returning Indians and help in avoiding administrative delays at the end of AD Banks.)

9. Exim Banks line of credit of USD 125 million to the Govt. of the Republic of Sudan

The Credit Agreement under the LOC is effective from December 20, 2013 and the date of execution of Agreement is July 24, 2013.

(A.P. (DIR Series) Circular No. 91 dated 13th January, 2014)

10. Risk Management and Inter-Bank Dealings

Hitherto, the facility of cancellation and rebooking was not permitted for forward contracts, involving rupee as one of the currencies, booked by residents to hedge current

and capital account transactions. However, exporters were allowed to cancel and rebook forward contracts to the extent of 50 per cent of the contracts booked in a financial year for hedging their contracted export exposures and importers were allowed to cancel and rebook forward contracts to the extent of 25 per cent of the contracts booked in a financial year for hedging their contracted import exposures.

In view of evolving market conditions and to provide operational flexibility in respect of current and capital account transactions, RBI has now decided to allow, in case of contracted exposures, forward contracts in respect of all current account transactions as well as capital account transactions with a residual maturity of one year or less to be freely cancelled and rebooked. With respect to forward contracts booked by FIIs/QFIs/other portfolio investors for their contracted exposures, upon cancellation, rebooked would be allowed only up to the extent of 10 per cent of the value of the contracts cancelled. The forward contracts booked by these investors would, however, be allowed to rolled over on or before maturity.

(A.P. (DIR Series) Circular No. 92 dated 13th January, 2014)

11. Clarifiaction – Establishment of Liaison Office/ Branch Office/ Project Office in India by Foreign Entities – General Permission

In terms of Regulation 4 of Notification No. FEMA.22/2000-RB dated May 3, 2000, Foreign Exchange Management (Establishment in India of Branch or Office or other Place of Business) Regulations, 2000, no entity or person, being a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran or China can establish a branch office or a liaison office or a project office or any other place of business by whatever name called in India without the prior permission of RBI.

RBI *vide* this circular has clarified that the above stipulation would also apply to entities from Hong Kong and Macau.

(A.P. (DIR Series) Circular No. 93 dated 15th January, 2014)

12. Clarification – Conversion of External Commercial Borrowing and Lump sum Fee/Royalty into Equity

An Indian company can issue equity shares against External Commercial Borrowings (ECB) subject to conditions mentioned therein and pricing guidelines as prescribed by the Reserve Bank from time to time regarding value of equity shares to be issued.

RBI has now given clarification regarding the rate of exchange that shall be applied to the amount in foreign currency borrowed or owed by the resident entity from/to the non-resident entity.

It is clarified that where the liability sought to be converted by the company is denominated in foreign currency as in case of ECB, import of capital goods, etc. it will be in order to apply the exchange rate prevailing on the date of the agreement between the parties concerned for such conversion. Reserve Bank will have no objection if the borrower company wishes to issue equity shares for a rupee amount less than that arrived at as mentioned above by a mutual agreement with the ECB lender. It may be noted that the fair value of the equity shares to be issued shall be worked out with reference to the date of conversion only.

It is further clarified that the principle of calculation of INR equivalent for a liability denominated in foreign currency as mentioned herein shall apply, *mutatis mutandis*, to all cases where any payables/liability by an Indian company such as, lump sum fees/royalties, etc. are permitted to be converted to equity shares or other securities to be issued to a non-resident subject to the conditions stipulated under the respective Regulations.

(A.P. (DIR Series) Circular No. 94 dated 16th January, 2014)

13. Merchanting trade transactions

Guidelines for merchanting or intermediary trade transactions have been reviewed accordingly:

i. Goods involved in the merchanting or intermediary trade transactions would be the ones that are permitted for exports / imports under the prevailing Foreign Trade Policy (FTP) of India, at the time of entering into the contract and all the rules, regulations and directions applicable to exports (except Export Declaration Form) and imports (except Bill of Entry) are complied with for the export leg and import leg respectively;

ii. Both the legs of a merchanting or intermediary trade transaction are routed through the same AD bank. The bank should verify the documents like invoice, packing list, transport documents and insurance documents and satisfy itself about the genuiness of the trade.

iii. The entire merchanting or intermediary trade transactions should be completed within an overall period of nine months and there should not be any outlay of foreign exchange beyond four months.

iv. The commencement of merchanting or intermediary trade would be the date of shipment/export leg receipt or import leg payment, whichever is first. The completion date would be the date of shipment/export leg receipt or import leg payment, whichever is the last;

v. Short-term credit either by way of suppliers' credit or buyers' credit will be available for merchanting or intermediary trade transactions including the discounting of export leg LC by an AD bank, as in the case of import transactions;

vi. AD bank should ensure one-to-one matching in case of each merchanting or intermediary trade transaction and report defaults in any leg by the traders to the concerned Regional Office of RBI on half yearly basis in the format as annexed. The deadline for submission of the report would be 15 calendar days after the close of each half year. In case of repeated defaults i.e. three cases or more in a year, ADs should restrain the traders from entering into any further transaction in merchanting or intermediary trade and consider recommending caution listing of the trader, to the Reserve Bank of India;

vii. The merchanting traders have to be genuine traders of goods and not mere financial intermediaries. Confirmed orders have to be received by them from the overseas buyers. Authorised Dealer should satisfy itself about the capabilities of the merchanting trader to perform the obligations under the order. The transactions should result in reasonable profits to the merchanting trader.

viii. The inward remittance from the overseas buyer should preferably be received first and the outward remittance to the overseas supplier will be made subsequently. Alternatively, an irrevocable Letter of Credit (LC) should be opened by the buyer in favour of the merchant. On the strength of such LC the merchant in turn may open a LC in favour of the overseas supplier. The terms of payment under both the LCs should be such that payment for import LC is required to be made after receipt of payment under export LC. The export LC should be issued in the name of original merchanting trader in India and import LC should be favouring the original supplier. In case export leg payment is received in advance, AD banks need not insist on opening of export LC.

ix. In case advance against the export leg is received by the merchanting trader, the advance payment may be held in

a separate deposit/current account in foreign currency or Indian Rupees. The amount required for import leg should be earmarked till the payment of import and should not be made available to the merchanting trader for use, other than for import payment or short-term deployment of fund limited to the import payable, with the same AD for the intervening period. If advance for the import leg is demanded by the overseas seller, the same should be paid against bank guarantee from an international bank of repute.

x. Reporting for merchanting or intermediary trade for compilation of R-return should be done on gross basis, against the undernoted codes :

Trade	Purpose Code under FETERS	Description
Export	P0108	Goods sold under merchanting/receipt against export leg of merchanting trade
Import	S0108	Goods acquired under merchanting /payment against import leg of merchanting trade

(A.P. (DIR Series) Circular No. 95 dated 17th January, 2014)

14. Clarification – Facilities for Persons Resident outside India

Foreign Institutional Investors (FIIs) are allowed to approach any AD Category – I bank for hedging their currency risk on the market value of entire investment in equity and/or debt in India as on a particular date subject to conditions specified therein.

It is clarified that a foreign investor is free to remit funds through any bank of its choice for any transaction permitted under FEMA, 1999 or the Regulations/Directions framed thereunder. The funds thus remitted can be transferred to the designated AD Category – I custodian bank through the banking channel. Note should, however, be taken that KYC in respect of the remitter, wherever required, is a joint responsibility of the bank that has received the remittance as well as the bank that ultimately receives the proceeds of the remittance. While the first bank will be privy to the details of the remitter and the purpose of the remittance, the second bank, will have access to complete information from the recipient's perspective. Besides, the remittance receiving bank is required to issue FIRC to the bank receiving the proceeds to establish the fact the funds had been remitted in foreign currency.

(A.P. (DIR Series) Circular No. 96 dated 20th January, 2014)

15. Know Your Customer (KYC) norms/Anti-Money Laundering (AML) standards/Combating the Financing of Terrorism (CFT) Obligation of Authorised Persons under Prevention of Money Laundering Act (PMLA), 2002, as amended by Prevention of Money Laundering (Amendment) Act, 2009 Money changing activities

Based on several representations received from Authorised Money Changers (AMCs), regarding difficulties in submitting Resolution of the Board of Directors for undertaking foreign exchange transactions with an AMC and also Power of Attorney granted to its officials to conduct forex transactions on behalf of the company, it has been decided to rationalise the same. Accordingly, the requirement of Resolution of the Board of Directors is being done away with and a corporate may now submit to the AMC a list of officials with names and signatures authorised by the Managing Director/Chief Financial Officer of the company to conduct forex transactions on its behalf. The amended instructions are given below:

	Extant Guidelines	**Revised Guidelines**
Features	Documents	
Establishment of Business Relationship – Corporate	Certified copy each of the following documents. i. Certificate of incorporation ii. Memorandum & Articles of Association iii. Resolution of the Board of Directors for undertaking forex transactions with the AP iv. Power of attorney granted to its managers, officers or employees to conduct forex transactions on behalf of the corporate and their identification v. PAN Card vi. Telephone Bill	Certified copy each of the following documents. i. Certificate of incorporation ii. Memorandum & Articles of Association iii. List of officials with names, designation and signatures authorised by the Managing Director/Chief Financial Officer of the company to conduct forex transactions on behalf of the company iv. PAN Card v. Telephone Bill Note: Corporate should invariably pay to AMCs towards rupee leg of forex transactions through a cheque/bank account of corporate irrespective of the amount of forex transaction

These guidelines are also applicable *mutatis mutandis* to all agents/franchisees of Authorised Persons and it will be the sole responsibility of the franchisers to ensure that their agents/franchisees also adhere to these guidelines.

(A.P. (DIR Series) Circular No. 97 dated 20th January, 2014)

16. Exim Banks line of credit of USD 19.50 million to the Govt. of the Socialist Republic of Vietnam

The Credit Agreement under the LOC is effective from December 27, 2013 and the date of execution of Agreement is July 11, 2013.

(A.P. (DIR Series) Circular No. 98 dated 27th January, 2014)

17. Foreign investment in India by SEBI registered long-term investors in Government dated securities

Present limit for investments by FIIs, QFIs and long term investors in Government securities stands at USD 30 billion, out of which a sub-limit of USD 5 billion is available for investment by long-term investors in Government dated securities.

It has now been decided that the existing sub-limit of USD 5 billion available to long term investors registered with SEBI – Sovereign Wealth Funds (SWFs), Multilateral Agencies, Pension/Insurance/Endowment Funds and Foreign Central Banks for investment in Government dated securities be enhanced to USD 10 billion, within the total limit of USD 30 billion available for foreign investments in Government securities.

(A.P. (DIR Series) Circular No. 99 dated 29th January, 2014)

(This is a good move by RBI with a view to attract more funds in India.)

Ajay Singh & Suchitra Kamble, *Advocates*

BEST OF THE REST

1. Compensation – Determination – Last pay certificate – Salary receivable by claimant on compassionate appointment – Cannot be termed as "Pecuniary Advantage" that comes under periphery of Act – Any amount received on such appointment is not liable for deduction – Motor Vehicles Act, 1988, S. 168.

An appeal was filed against the judgment of the High Court upholding the compensation awarded by the Motor Accident Claims Tribunal on the basis of the calculating amount of compensation taking into all the factors and evidence on record.

The Supreme Court held that none of the respondents brought to the notice of the Court that the income-tax payable by the deceased was not deducted at source by the employer i.e. State Government. The Tribunal or the High Court had not noticed the income-tax on the estimated income of the employee was deducted from the salary of the employee during the said month or Financial Year. In absence of such evidence, it is presumed that the salary paid to the deceased as per Last Pay Certificate was paid in accordance with law i.e. by deducting the income-tax on the estimated income of the deceased for that month or the Financial Year. It further held that High Court was wrong in deducting 20% from the salary of the deceased towards income-tax, for calculating the compensation. As per law , the presumption will be that employer – State Government at the time of payment of salary deducted income-tax on the estimated income of the deceased employee from the salary and in absence of any evidence, it could be said that the salary as shown in the Last Pay Certificate.

Compassionate Appointment can be one of the conditions of service of an employee, if a scheme to that effect is framed by the employer. In case, the employee dies in harness i.e. while in service leaving behind the dependents, one of the dependents may request for compassionate appointment to maintain the family of the deceased employee dies in harness. This cannot be stated to be an advantage receivable by the heirs on account of one's death and have no correlation with the amount receivable under a statute occasioned on account of accidental death. Compassionate appointment may have nexus with the death of an employee while in service but it is not necessary that it should have a correlation with the accidental death. An employee dies in harness even in normal course, due to illness and to maintain the family of the deceased one of the dependants may be entitled for compassionate appointment but that cannot be termed as "Pecuniary Advantage" that comes under the periphery of Motor Vehicles Act and

any amount received on such appointment is not liable for deduction for determination of compensation under the Motor Vehicles Act.

Vimal Kanwar & Ors. vs. Kishore Dan & Ors. AIR 2013 SC 3830

2. Dispute regarding correctness of meter – Can be decided only by electrical inspector : Electricity Act, 1910, S. 26

The Plaintiff Company, a regular consumer of the Electricity Board was intimated to pay towards slow operation of meter upon alleged test and assessment. There was a dispute which was pending and undecided with the Electrical Inspector. The Trial Court held that the Plaintiff was entitled for the relief of perpetual injunction and held that the Board was not entitled to disconnect the electric supply of the Plaintiff Company.

The High Court held that on conjoint reading of various sub-sections of Section 26 of the Electricity Act, it is evident that consumption of electricity or electrical quantity in the supply, shall be ascertained by means of a correct meter and the meter and other apparatus for recording the consumption of electricity by a consumer will be deemed to be correct if the recording is within the permissible limit of error as prescribed. If a dispute as to the correctness of the meter is raised by any party for reference, such dispute can be decided only by the Electrical Inspector and both the licensee and the consumer has to accept the estimate of supply of electricity to the consumer as may be determined by the Electrical Inspector for the statutory period referred to in sub-section (6) of Section 26. By the amendment of sub-section 6 the Electrical Inspector has been purposely absolved from the duty to determine as to from which point of time beyond the said statutory period, the meter had ceased to function so that for such entire period, the estimation of the supply of electricity need not be made. Such amendment of subsection (6), only means that beyond the statutory period, in the event of dispute between the parties as to the proper functioning of the meter and other electrical apparatus, the consumer has liability to pay the estimated amount indicated by the Electrical Inspector limiting the up to the statutory period and not beyond that but for the other anterior period the consumer is required to pay according to the consumption of electricity registered in the disputed under meter provided there is no fraud practiced by the consumer because dispute of such anterior period remains unresolved by the change introduced by the amendment. In view of Section 26(6) the Board will be precluded from raising any demand contrary to the liability of the consumer and consequently will not be entitled to disconnect the electricity for any earlier period for non-payment for the consumption of electricity.

Maharashtra State Electricity Board, Thane & Anr. vs. M/s. Hindustan Gas Industries Limited & Anr. AIR 2013 Bombay 183

3. Assignment Deed – Registration on basis of unregistered power of attorney – Power of attorney falling u/s. 32(a) or 32 (b), not required to be registered – Direction given to Register assignment deed on basis of unregistered power of attorney: Registration Act, 1908, S.32(a),(b), (c).

In the present case the challenge was to the order refusing to register assignment deed presented in favour of the petitioner and affirming the order passed by the Sub-Registrar. Axis Bank through its agent presented an assignment deed for registration before the Sub-Registrar. The said document was not registered by the Sub-Registrar for the reason that it is based upon power of attorney executed by UTI Bank and was not a registered document. The said order was affirmed in Appeal.

The High Court held that as per Section 32 of the Act, all documents are required to be presented for registration by person executing the document; any person claiming under the document presented for registration, and; in case the said document is a copy of a decree or order, any person claiming under the decree or order. A reading of Section 32 (c) show that the power of attorney required to be executed and authenticated in the manner hereinafter mentioned i.e. Section 33 if the presentation is by agent of such a person, representative or assign, on whose behalf the document is being presented for registration. But if the document is by the representative or assign of a person in terms of Section 32(a) or (b), who is executing the document, the same is not required to be presented by a person on the basis of a registering document in terms of Section 33 of the Act. In terms of Section 32 of the Act, the person who actually signs or marks the document in token of execution whether for himself or on behalf of some other person, is the person executing the document. Thus, "person executing" as used in Section 32 (a) of the Act signifies the person actually executing the document and includes a principal who executes by means of agent. In the present case the assignment deed was presented by the principal through its representative on the strength of notarized power of attorney. Such presentation is in terms of Section 32(a) of the Act. Such attorney is also by the representative of a person executing the document falling under Section 32(b) of the Act, but such power of attorney does not fall within Section 32(c) of the Act, which alone would require registration in terms of Section 33 of the Act. Therefore, the Sub-Registrar was directed to register the document in accordance with law.

International Asset Reconstruction Company Pvt. Ltd. vs. State of Punjab & Ors. AIR 2013 Punjab and Haryana 216

4. Adoption – Validity – Condition of Age – Hindu Adoption and Maintenance Act, 1956, Ss. 10, 11

The Plaintiff filed a suit for declaration that the registered gift deed alleged to have been executed by defendant No. 1 in favour of defendant No. 2 and 3 in respect of the suit land has to be set aside. A decree for permanent injunction was sought for restraining defendant No. 1 from alienating the land as per schedule. The trial court in its judgment held that the plaintiff is the legally adopted son of deceased defendant No. 1 and suit property was not the ancestral property, hence Defendant No. 1 is entitled to alienate the property and dismissed the suit.

The Supreme Court held that under Clause (iv) of Section 10, one of the conditions is that the person who may be adopted has not completed the age of 15 years unless there is a custom and usage applicable to the parties which permit persons who completed the age of 15 years being taken in adoption. The other condition for a valid adoption has been provided in Section 11 (iv) of the Act which states that the child to be adopted must be actually given and taken in adoption by the parents or guardian concerned or under their authority with the intent to transfer the child from the family of its birth. A child who is abandoned or whose parentage is not known may also be taken in adoption provided the given and taken ceremony is done from the place of family where it has been brought up to the family of its adoption. Both the first Appellate Court and the High Court have considered all the decisions relied upon by the parties and finally came to the conclusion that neither the custom has been proved nor the factum of adoption has been established by conclusive evidence. Thus the appeal was dismissed.

Harnek Singh v. Pritam Singh & Ors. AIR 2013 Supreme Court 3789

5. Instrument of gift – Chargeability to stamp duty – Stamp duty is to be charged on basis of value of property – Matter of gift – Method prescribed for valuing 'building' as provided under R. 5 (c)(i) has to be followed: Stamp Act, 1899, Sch. 1-B(U.P.), Art. 13

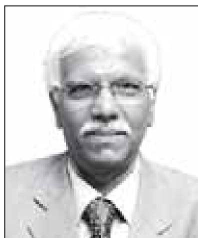
The Petitioner challenged the order passed by the collector and the appellate order passed by the Chief Controlling Revenue Authority in proceedings under the Indian Stamp Act, 1899 for determining the deficiency in stamp duty on the instrument of gift deed and corrigendum deed forming part of it. There was no dispute to the nature of the instrument and the same is admitted to be deed of gift of land on which construction was in progress. The Petitioner in the said deed of gift disclosed the value of the land but not of the construction and paid stamp duty on the value of the land alone as per the prevailing circle rate. The authorities on the basis of the report of technical committee held that the construction existing over the said land was of specific value more than the land value and as such above value of construction was directed for payment of stamp duty.

An instrument of gift is chargeable to stamp duty under Article 33 of Schedule 1-B of the Act. A plain reading of the said Article makes it clear that stamp duty on a gift deed is chargeable as is provided under Article 23 clause (a) of Schedule 1-B on a deed of conveyance of sale on a consideration equal to the 'value of the property'. In Article 23 of Schedule 1-B of the Act the expression used is 'value of the consideration of such conveyance as set forth or the market value of the immovable property which is the subject of such conveyance, whichever is greater'. Thus, in the said Article the emphasis is on consideration as set forth or the market value of the immovable property whichever is greater whereas in relation to a gift deed it is simply value of the property. There is a marked difference in the "market value of the property" and the "value of the property" as used in the above Articles. To avoid illusory valuation and to ensure that the value of the property disclosed is just, fair and reasonable, The Uttar Pradesh Stamp (valuation of Property) Rules, 1997 framed in exercise of power under Sections 27, 47-A and 75 of the Act vide Rule 5 lays down the method of calculation of minimum value of land and building both commercial and non-commercial. It provides that value of the building which is non-commercial is to be determined by taking the minimum value of the land whether covered by the construction or not but which forms part of the instrument plus the value of the construction arrived at by multiplying the constructed area of each floor of the building by the minimum value fixed by the Collector of the district under Rule 4 of the Rules. Thus the High Court remanded the matter to the authorities and directed the collector for re-determination of the value of the property involved in the gift in accordance with law as per Rule 5 of the Act.

Jagadguru Kripa Parishat vs. State of U. P. & Ors. AIR 2013 Allahabad 196

Our bodies are our gardens – our wills are our gardeners.

— *William Shakespeare*



Kishor Vanjara, *Tax Consultant*

TAX ARTICLES FOR YOUR REFERENCE

Articles published in Taxman, Current Tax Report (CTR), The Tax Referencer (TTR), Income Tax Review (I. T. Review), Sales Tax Review (S. T. Review), The Bombay Chartered Accountant Journal (BCAJ), All India Federation of Tax Practitioners Journal (AIFTPJ), The Chartered Accountant (CAJ), The Chamber's Journal (CJ), Sebi And Corporate Laws (S & Co. Laws), Company Case, Times of India, Economic Times for the period December to January 2014 has been arranged and indexed topic-wise.

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After you're older, two things are possibly more important than any others: health and money.

— *Helen Gurley Brown*

CA. Rajaram Ajgaonkar

ECONOMY AND FINANCE

INCREASING VULNERABILITY

The month of January has not been very encouraging for the global economies and specially those of the developing countries across the world. Though the first half of the month was reasonably encouraging, the second half brought to the fore certain structural imbalances, which caused anxiety. The US has commenced the process of reversing of the quantitative easing; and that has started adversely affecting the emerging economies of the world. As a first step of reversal, the buyback of bonds by the US Fed was reduced from 85 billion US dollars to 75 billion US dollars a month. The move was good enough to rock the emerging markets. The easy money which was floating in those markets, started returning to the US as its economy was on a clear upward move. This has resulted in depreciation of currencies of many developing countries within a very short span of time. In the effort to control the outward movement, the Central banks of some of the countries tried to increase interest rates, which have increased the worry of slowdown in these economies due to higher cost of borrowings. When the US Fed started quantitative easing, many of the emerging markets had gained, as fallout of the same. Excess liquidity flew from the US market to these emerging markets, which were looking more attractive. The cheap money flow strengthened their currencies and also gave a fillip to these economies. So long as the quantitative easing was in full force, the inward fund flow remained unabated to these economies; and their dependence on this money increased. Though a lurking fear of returning of this money obviously remained, everybody thought of making hay while the sun was shining. Since the announcement of tapering of the quantitative easing by Fed, things started worsening for these economies. The recent decision of the Fed to accelerate the tapering by reduction in bond purchase to 65 billion US dollars a month has created further risk, which can accelerate the outflow of funds from the emerging markets. Their currencies are weakening and may continue to weaken further. The contagion effect of tapering by the fed is likely to spread across the world, mainly to smaller economies and if not properly managed, it can cause economic havoc over the next few months.

Unfortunately, it seems that the US may play its game solo. The quantitative easing was started by that country for the benefit of its own economy, though through the massive

influx of funds, it positively affected large number of other countries wherein the US investors had economic interest. However, this move was a US specific move and it was not initiated for the benefit of any other country but itself. Now, as the US has reaped the benefits of the quantitative easing and its economy has started gradually improving, the US Fed has started the tapering of the same as a natural consequence. Even morally, the US was not required to consult any other country or get concerned about the effects of the same on any other country. However, it is evident that its action is going to affect the rest of the world. What is in the best interest of the US economy may not be in the best interest of the rest of the world. In fact, some of its moves can turn out to be hazardous for some countries, which are directly or indirectly dependent on the US funds and its demand for goods. Therefore, the job of the US Fed Chairman is going to be more difficult over the next few months to come. By just tapering the quantitative easing by less than 25%, many economies in the world are feeling the heat. It is difficult to gauge what would have been the state of the world economy, if gradual approach to the tapering would not have been taken by the US. The US does not have a choice but to roll-back the quantitative easing and eventually withdraw the same. It is inevitably going to create pain for many, but there may not be any easy solution out of the same. The sting of the easing can be reduced by policy intervention by the International Monetary Fund but there is no certainty about the same. It is desirable for the US to take those economies in confidence to the possible extent, so that their hardships may be mitigated. The months ahead can be painful to many countries, their currencies, interest rates and therefore their economic growth. There are risks of hyper-inflation in some countries and some currencies may lose their value sharply. There is also a risk of the US economy losing momentum, because if many countries suffer, the US may not be able to totally isolate itself.

But for this risk, the world economy seems to be in better shape. The economic growth is accelerating in the US, employment is increasing and trade deficit is coming down, which flash positive signals. The European economy has also started gradually improving and the progress is likely to continue. The United Kingdom had one of the best growth quarters in the recent years and it is likely to get in a better shape over the next few quarters. The signals in the developed countries are much positive than before and they may continue to remain so in the near future. Now the centre of risk has shifted from the developed economies to the developing economies. The current state of affairs can create dissatisfaction in many pockets of the world and may cause even miseries in some economies.

It seems that the Chinese economy has started slowing down. Its growth rate is likely to get tapered over the next few quarters. Though China has been growing well, there is likelihood of bubbles being formed in many asset classes in that economy. Chinese debt is high and it can pose some problems in the quarters to come. Though the slowdown may be gradual, it may adversely impact the growth rate. The Chinese economy being the second largest in the world, its slowing is very likely to have an effect on the overall growth rate of the world. Its slowdown in production can create supply problems for many economies and simultaneously can negatively affect global demand of many raw materials such as commodities, metals and petroleum products. China, being a disciplined and a controlled economy, the possibility of a sudden bounce-back cannot be ruled out though as of now, the chance of it happening appears remote.

The growth story of India seems to have been affected even before the Fed tapering had started. Continuously over the last four years, the economic growth is falling from the rate of growth of 8.9% achieved in 2009-10, it has tanked to 4.5% for the financial year 2012-13. Many believe in the resilience of the Indian economy to the negative global developments; and the same may be true to an extent. However, now India seems to be harbouring its own problems and not able to overcome the same. The reforms process has slowed down, inaction of bureaucracy has increased, self centered politics has created obstacles and it seems that growth has been left to be managed by the citizens of the country. Talent of Indian entrepreneurs is very high and they can surmount enormous negative factors. However, growth in India will take some time to revive. High inflation has saddled the economy with high interest rates. In spite of continuous efforts of RBI, inflation is not taming adequately. Indian businesses are traditionally managed through high amount of debt and low equity. Therefore Indian businesses, especially the small businesses, are becoming vulnerable in the recent years. High interest outflows are restricting profits and capital formation. Uncertainty is an additional dampener and there are no signs of it curing for at least 6 more months, till the Parliamentary elections are over. It may continue, if a hung parliament comes into existence. Though the markets had reached an all time high in the month of December, the uncertainty never reduced. Now the effect of US tapering is also felt by the Indian economy. The month of January is traditionally a month of high inflow of foreign funds in Indian equity market. However, January 2014, was nearly a washout month and hardly any funds came in from the FIIs on a net basis. Apparently, there is no reason that things can change drastically in the near future and especially till the political scenario gets clearer. Emergence of a possibility of a third front is also a political dampener and has added to the uncertainty. Therefore, the investment climate is likely to remain hesitant in India for at least the next few months. Though the economic undercurrent is getting positive and it is said that the worst is over, a cautious stance is required by the Indian investors.

Stock markets across the world were on a high till December 2013 and they were expected to do even better. Concerns of growth were fading and better days were expected for the global economies. Though the tapering of the quantitative easing was an issue, it was felt that as it will be gradual, it will not affect growth. However, since the time it has started, the impact is much more severe than expected. A small tapering of 10 billion US Dollars has already made the currency markets of developing countries topsy-turvy. Interest rates have spiked and stock markets have plunged. The negative impact on the stock markets has not remained restricted to the emerging markets but it has also affected the developed economies and stock markets therein. Most of the indices have tanked 5 to10% from their recent peaks achieved just a few days back. Unfortunately, lot of tapering is yet to come and how negatively it can affect the world can be anybody's guess. There is a strong reason to remain cautious on the stocks from emerging economies. They are likely to remain range bound with a negative bias. There is a possibility that even the developed markets may shed other 5 to 10% values over the next few months. Stocks as a long-term asset class remain attractive, but its short-term movement can be uncertain and volatile. Investors are advised to remain cautious till the effect of quantitative easing is more evident and becomes predictable.

In the recent policy review, RBI has increased the Repo rate, which will increase the cost of funds for the banks. The last

quarter of a financial year is a tight liquidity season of the year and therefore the interest rates may continue to remain strong and harden a bit. There is a possibility that many banks may increase their deposit rates by a quarter per cent before March. Investors can invest in medium term fixed deposits over the next few months to take advantage of high interest rates. Bond yields have strengthened and may remain so for the next couple of months. The fall, if any, can be slight and for a short term. After the elections, the bond yields are likely to come down. Investors can get not only benefit from high yields, but they can also benefit from capital appreciation. Time seems to be opportune for investments in short and medium term bonds of well rated companies. Even tax free bonds and Government securities are giving attractive returns and one can add them to their portfolio based on one's asset allocation preference.

On the back of high interest rates and tight liquidity, the property markets continue to remain subdued across India. They are not likely to improve for some more time as the tough conditions may continue. Property markets in developed countries have started improving due to improved economy and very low interest rates prevailing therein. These markets should gradually strengthen over the next few years. Today may be the opportune time to invest in exotic properties at the destination of one's choice outside India. However while doing so, it is essential to adhere to all rules and regulations of India as well as the investee country.

Indian investors may also think about investing in certain feeder funds which ultimately invest in the markets of US or Europe. These economies are likely to perform better in the near future and the companies therein are likely to declare better results. As Indian Rupee is expected to depreciate, these investments will not only earn returns by way of dividend and capital appreciation of the underlying assets but they will also appreciate due to devaluation of the Indian Rupee. As Indian residents have limited scope of hedging the depreciation of Indian Rupee, it may be advisable to invest in such assets to partially hedge against the depreciation.

Gold rises when uncertainty increases. The Fed tapering has already impacted the developing markets and uncertainty has increased therein, resulting in appreciation of the price of gold. If the same continues and if these markets weaken further, gold may strengthen. However, such rise is likely to be temporary and will fade out when the uncertainty recedes.

The calendar year 2013 ended on bullish note and a peep in 2014 was suggesting a great year ahead. However, the year has started with uncertainties and they may continue, as the quantitative easing is tapered. What may be the consequence of the Fed tapering can be anybody's guess. Still, the risks are substantial for the emerging markets and cannot be ignored. Investors are advised to take a cautious view and book profits periodically, when possible. The movement of the markets may throw open many trading opportunities than investment opportunities.

> Healing is a matter of time, but it is sometimes also a matter of opportunity.
>
> — *Hippocrates*

V. H. Patil, *Advocate*

YOUR QUESTIONS & OUR ANSWERS

Facts & Query

Q.1 Mr. A holds 10,000 shares of ITC. Recently rates of ITC shares went up and Mr. A sold 10,000 shares of ITC in future market. After sometime the rate of ITC share came down and Mr. A bought again 10,000 shares in future market, thereby making a decent profit.

Queries

a) Whether profit made by Mr. A is taxable?

b) If yes, under which head of income or can it be reduced from the cost of ITC shares in the books of Mr. A?

Ans. The relevant provision of I.T. Act dealing with speculative transaction is S. 43(5) of the I.T. Act, which is as under:-

S. 43(5). "speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stock and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or the scrips.

Provided that for the purposes of this clause –

(a) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him; or

(b) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or

(c) a contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member; [or]

(d) an eligible transaction in respect of trading in derivatives referred to in clause [(ac)] of section 2 of the Securities Contracts (Regulation) Act 1956 carried out in a recognised stock exchange;

shall not be deemed to be a speculative transaction.

In view of this definition of speculative transaction, as the querist has not taken the delivery of shares nor he has given delivery of shares on sale, it would have been a speculative transaction, however as the sale is in future market in recognised stock exchange, it will not be treated as speculative gain or loss and as such it would be taxable as business income. However it is not exempted from taxation.

Q.2 An advocate expired in middle of 2013. After the death of advocate in middle of 2014 the legal heirs of the said advocate received fees from certain clients for the work done by the said advocate when he was alive. Parties have deducted tax at source when the payment is made.

Queries:

a) Whether the receipt of outstanding fees are at all taxable in the hands of the legal heir/executors.? If it is taxable under which head of income?

b) If income is not taxable then what happens to tax deducted at source ?

Ans. Under the provision of S. 159 of I.T. Act a provision is made provide for assessment of legal heirs of a deceased assessee.

S. 159. (1) Where a person dies, his legal representative shall be liable to pay any sum which the deceased would have been liable to pay if he had not died, in the like manner and to the same extent as the deceased.

(2) For the purpose of making an assessment (including an assessment, reassessment or recomputation under section 147) of the income of the deceased and for the purpose of levying any sum in the hands of the legal representative in accordance with the provisions of sub-section (1), —

(a) any proceeding taken against the deceased before his death shall be deemed to have been taken against the legal representative and may be continued against the legal representative from the stage at which it stood on the date of the death of the deceased;

(b) any proceeding which could have been taken against the deceased if he had survived, may be taken against the legal representative; and

(c) all the provisions of this Act shall apply accordingly.

(3) The legal representative of the deceased shall, for the purposes of this Act, be deemed to be an assessee.

(4) Every legal representative shall be personally liable for any tax payable by him in his capacity as legal representative if, while his liability for tax remains undischarged, he creates a charge on or disposes of or parts with any assets of the estate of the deceased, which are in, or may come into, his possession, but such liability shall be limited to the value of the asset so charged, disposed of or parted with.

(5) The provisions of sub-section (2) of section 161, section 162, and section 167, shall, so far as may be and to the extent to which they are not inconsistent with the provisions of this section, apply in relation to a legal representative.

(6) The liability of a legal representative under this section shall, subject to the provisions of sub-section (4) and sub-section (5), be limited to the extent to which the estate is capable of meeting the liability.

Now the professional fees of the deceased assessee have already accrued, through outstanding, because of non-receipt. The legal heirs of the deceased assessee will be liable to be taxed in respect of their shares in the estate of the deceased but at the rate of tax, which was applicable to the deceased assessee.

However, in case of executors, they are not individually liable but as a unit of taxation as a representative assessee they are taxable on the entire income of the such unit and it is taxable at the rate applicable in the entire income of that unit.

Q.3 Mr B has booked under construction flat in the year ***2009 for ` 80 lakhs by paying ` 2 lakhs and the balance in various installments the last payment being made in 2012. No agreement has been entered into till date. Nor has*** *possession been obtained. Mr. B would like to sell his rights in the said flat to a third party.*

Queries:

a) ***Is the amount received from the buyer subjected to*** *tax? If yes, which head?*

b) ***If capital gains what will be the date of acquisition*** *and whether he is entitled to any exemptions?*

Ans. Under General Law, a transfer is complete only when an unconditional possession of the property, the subject matter of transfer is handed over to the transferee by the transferor or when a conveyance relating to that property is executed and the document of conveyance is duly registered. Till then the transfer is not complete under the provisions of Transfer of Property Act and also under I.T. Act, 1961.

Applying these provisions of taxation of profits in case of building contract, relating to construction of a building for a co-operative society, the transfer of property is completed, only when an unconditional possession of the property under development of the premises constructed on the said land, is given to the Developers, or when on unconditional possession is given to the purchaser of the flats constructed or when final conveyance deed is executed between the owner of the property and the co-operative society formed and duly registered and such society

on proper application from concerned persons, accepts such purchaser as a member of the co-operative society so formed. Till then the transfer is not complete in case of the original owner and the developer and flat purchasers, etc., and there arises no liability to taxation.

Now in case of the flat purchaser his liability for taxation will be for capital gain and not for the business income.

The transfer in the case of querist would take place when an unconditional possession is given to the querist or when a final conveyance is executed between the original owner of the plot under construction and the co-op. society when it is formed and is duly registered.

Now in the case of the querist purchaser of a flat, when an informal agreement was entered into with the builder he got an interest in the flat which he has agreed to purchase which can be transferred and the profit from such transfer, he is making will be liable to be taxed as capital gain. It will be liable to be taxed as long from capital gain. It will not exempt from taxation.

Q.4 A Pvt. Ltd. Co. with distributable reserves of ` 10 crores advanced temporary loans to its director which was repaid within a short period. Details of loan given and repaid are as under:

1. *Loan of ` 20 lakhs given on 1st may and repaid on 15 May*
2. *Loan of ` 50 lakhs given on 30 June and repaid on 20 July*
3. *Loan of ` 30 lakhs given on 4th September and repaid on 30 September*

The AO is of the opinion that ` 1 crore is deemed dividend

The AR is of the opinion that only peak credit which is 50 lakhs is deemed dividend.

Ans. A temporary payment of some money for a short period may not amount to a loan. In any case the same amount of loan cannot be added twice. In the case of the querist, when the loan of ` 50 lakhs was given, the earlier loan of ` 30 lakhs was already paid back, similarly when ` 30 lakhs was given the earlier loan was ` 50 lakhs was already returned and as such the querist is right in its contention that only the peak of ` 50 lakhs may be treated as deemed dividend not ` 1 crore as contended by the I.T.O.

Q.5 A Private Limited Company incorporated in India under Companies Act, 1956 having 100% share capital owned by foreign Collaborator Company of Germany. The Parent Company generally exports goods to this company in India. The Company being one of the subsidiaries of the Foreign Parent Company who also has many companies under their arms and fully financed by them situated abroad. Parent Company (Foreign Company) along with other Foreign Subsidiaries provide various services and supports to Indian company. The Holding Company and their foreign Subsidiary Companies, charge share of Insurance premiums for managerial staff in India, share of services allocation agreement fees, service charge, service fees, interest on delayed payments and software support charges and its maintenance expenses. The main Holding company (Parent Company) alongwith other subsidiary Companies situated abroad are sending their various Debit Notes to the Indian Companies for making their payments in foreign currency in respect of the above services. Nowhere it is mentioned that this is the share of actual expenses. We feel that the amount received by the Foreign Companies will directly hit their Profit & Loss Account in one way or the other. All the above companies do not have their PAN Account Numbers in India. Under the circumstances kindly advice whether 20% TDS (withholding Tax) is required to be deducted from remittances made to the non-residents u/s 195 of the Income-tax Act.

Ans. Now if one properly analyses the facts of the querist's case it is clear that only the expenses actually incurred were shared by holding company with its subsidiary companies. In any case any payment by and from a holding co its subsidiary does amount to payment to oneself and as such payment is not payment which is taxable in India and as such no TDS may be made on such payment u/s. 195 of I.T. Act, 1961.

CA Hitesh R. Shah & CA Hinesh R. Doshi, *Hon. Jt. Secretaries*

THE CHAMBER NEWS

Important events and happenings that took place **between 8th January, 2014 to 8th February, 2014** are being reported as under.

I. Admission of New Members

1) The following new members were admitted in the Managing Council Meetings held on 18th December, 2013 and 24th January, 2014.

LIFE MEMBERSHIP

18th December, 2013

1	Shri Gada Vinit Dinesh	CA	Mumbai
2	Shri Karani Siddharth Bipin	CA	Mumbai

24th January, 2014

1	Shri Shah Akshay Rajendra	CA	Mumbai
2	Shri Shah Jignesh Virendra	CA	Ahmedabad
3	Shri Vanjara Parth Kishor	Advocate	Mumbai
4	Shri Gandhi Rajesh Harishchandra	CA	Mumbai
5	Shri Kapasi Abbasi D.	ITP	Mumbai
6	Mrs. Mehendale Kavita Kedar	CA	Mumbai

ORDINARY MEMBERSHIP

18th December, 2013

1	Shri Jajoo Ramesh Ramnath (Oct. 13 to Mar. 2014)	CA	Nashik
2	Shri Shridharani Deep Tushar (Oct. 13 to Mar. 2014)	Advocate	Mumbai
3	Shri Mehta Brijen Chetankumar (Oct. 13 to Mar. 2014)	CA	Ahmedabad
4	Shri Deodhar Mangesh Prakash (Oct. 13 to Mar. 2014)	CA	Mumbai
5	Shri Jain Sampat Dulharaj (Oct. 13 to Mar. 2014)	CA	Mumbai
6	Shri Someshwar Umang Hasmukh (Oct. 13 to Mar. 2014)	CA	Mumbai
7	Mrs. Sheth Pooja Harshit (Oct. 13 to Mar. 2014)	CA	Ahmedabad

8	Ms. Patel Pragna Ramjibhai (Oct. 13 to Mar. 2014)	CA	Mumbai
9	Shri Rodrigues Elroy Lawrence (Oct. 13 to Mar. 2014)	CA	Mumbai
10	Shri Sah Chandra Shekhar (Oct. 13 to Mar. 2014)	CA	Mumbai
11	Shri Singavi Vishal Vijaykumar (Oct. 13 to Mar. 2014)	ITP	Thane
12	Shri Ved Ashit Mansinh (Oct. 13 to Mar. 2014)	ITP	Mumbai
13	Shri Bhuteria Mohit	CA	Kolkata
14	Shri Chandaria Bhavik Hasmukh	CA	Mumbai

24th January, 2014

1	Shri Shah Bharat Shantilal (2014-15)	ITP	Mumbai
2	Shri Patel Jaykumar Bipinchandra (2013-14)	CA	Ahmedabad
3	Ms. Shah Kinjal Shreyas (Oct. 2013 to Mar. 2014)	CA	Mumbai
4	Shri Lalka Hiren Raychand (Oct. 2013 to Mar. 2014)	CA	Mumbai
5	Shri Hathi Pradeep Nethichandra (Oct. 2013 to Mar. 2014)	CA	Mumbai
6	Shri Joshi Vishal Surendra (Oct. 2013 to Mar. 2014)	CA	Mumbai
7	Shri Surana Kapilkumar Shokin (Oct. 2013 to Mar. 2014)	CA	Mumbai
8	Shri Verma Swaroop Gajadhar (Oct. 2013 to Mar. 2014)	CA	Mumbai
9	Miss. Maheshwari Neena Premchand (Oct. 2013 to Mar. 2014)	CA	Kolkata

ASSOCIATE MEMBERSHIP

24th January, 2014

1	Axis Bank Limited	Mumbai

II. Past Programmes

Details of programmes conducted by the Chamber are given below:

Sr. No.	***Programme Name / Committee/Venue***	***Date/Subjects***	***Chairman/Speakers***
1	**Direct Taxes Committee**		
	7th Intensive Study Group (Direct Tax) Meeting Venue – CTC Office	**21st January, 2014** Recent Important Decisions under Direct Taxes	Shri Vinod Kumar Jain, Advocate
2	**Indirect Taxes Committee**		
	Workshop on MVAT Act & Allied Laws (Jointly with STPAM, BCAS, AIFTP & WIRC of ICAI) Venue – Mazgaon Library, Vikrikar Bhavan, Mumbai.	**18th, 24th January & 2nd February, 2014** • Practical Aspects under Business & Refund Audit Input Tax Credit, Cross Checks, ITC claim as per Sec. 48(5)	CA Rajat Talati CA Janak Waghani Shri Ratan Samal, Advocate Shri C. B. Thakar, Advocate CA Vikram Mehta CA Ashit Shah

Sr. No.	*Programme Name / Committee/Venue*	*Date/Subjects*	*Chairman/Speakers*
		• Power of Review, Rectification, Reassessment and Appeal Proceedings conducted by Department • Power of DDQ, Survey, Search and Seizure Proceedings Conducted by Department • Intricate Issues under Works Contracts under – MVAT Act – CST Act • Construction Service including Works Contract Services, Erection & Commissioning Services	
3	**Information Technology Committee**		
	Info Tech Update Series Workshop Venue – Babubhai Chinai Committee Room, IMC	**23rd January, 2014** Smart apps for Tax Professionals (How to get the most out of your smart phone)	CA Sanjay Chheda CA Samir Kapadia
4	**International Taxation Committee**		
A)	*Intensive Study Group on International Taxation Meeting* Venue – CTC Conference Room	**4th February, 2014** Fundamental Principle of Royalty taxation, Historical development of Royalty taxation Source Rules in the Treaties and under the Income-tax Act	Shri Rajesh L. Shah & Shri Ganesh Rajgopalan
B)	*Transfer Pricing Study Circle Meeting* Venue – Kilachand Hall, IMC	**28th January, 2014**	The Inaugural Meeting of the Transfer Pricing Study Circle

Sr. No.	*Programme Name / Committee/Venue*	*Date/Subjects*	*Chairman/Speakers*
5	**Membership & EOP Committee**		
	Self Awareness Series Venue – CTC Office	**8th January, 2014]** Universality of Indian Culture	CA Jawahar Baxi
6	**Residential Refresher Course & Public Relations Committee**		
A)	*2nd Chamber Premier League, 2014 (CPL) – Cricket Match* RRC & PR Committee jointly with Membership & EOP Committee	**18th January, 2014**	
7	**Study Circle & Study Group Committee:**		
A)	*Study Circle on International Taxation Meeting* (Jointly with Intensive Study Group on International Taxation) Venue – Kilachand Hall, IMC	**16th January, 2014** Discussion of brief report on the UN Meeting of Committee of Experts on International Co-operation in Tax Matters (October, 2013) & Taxation of E-Commerce – Issues & Views	CA Nilesh Kapadia
B)	*Study Group Meeting* Venue – Babubhai Chinai Committee Room, 2n Floor, IMC	**30th January, 2014** Recent Judgments under Direct Taxes	Shri Vipul B. Joshi, Advocate
8	**Delhi Chapter**		
A)	*Study Circle Meeting* Venue – Lecture Room I, India International Centre	**8th February, 2014** Service Tax and VAT on Composite and Cross Border transactions	Shri Abishek Jain Shri Saurabh Aggarwal from KPMG
III.	**Future Programmes** Future programmes of the Chamber's are as follows:		
1	**Allied Laws Committee**		
A)	*Full Day Seminar on Charitable Trusts* (Jointly with BCAS) Venue – M. C. Ghia Hall, Kalaghoda, Mumbai – 400 023	**22nd March, 2014** 1. Key Note Address/ Recent Issues in Case of Charitable Trusts	Deputy Charity Commissioner, DIT (Exemption) &

Sr. No.	***Programme Name / Committee/Venue***	***Date/Subjects***	***Chairman/Speakers***
		2. Important Provisions of Bombay Public Trust Act, Drafting of Trust Deed, etc. 3. Formation of Trust, Provisions relating to Accounts & Audit, etc. 4. Registration u/ss. 12AA, 80G & 10 (23 C) of I. T. Act, 1961 5. Taxation of Charitable Trust 6. Provisions of Foreign Contribution Regulation Act and DTC	CA Arvind Dalal, Chairman Eminent Faculty CA Vipin Batavia CA Paras Savla CA Gautam Nayak CA Anil Sathe
B)	*Allied Laws Study Circle Meetings*	**6th March, 2014** Section 53A of Transfer of Property Act & Stamp Duty Provisions on Agreement for Sale	Shri J. S. Solomon, Advocate & Solicitor
		26th February, 2014 Wills & Testamentary Succession	Ms. Shaishvi R. Kadakia, Advocate & Solicitor
2.	**Corporate Members Committee**		
A)	*Workshop on Companies Act, 2013* Venue – Babubhai Chinai Hall, IMC	**14th, 15th, 28th & 29th March, 2014** **1.** Overview of Companies Act, 2013	Inaugural Address : *Shri K. L. Kamboj, Ragional Director, Western Region, MCA. Overview of Companies Act, 2013, Dr. S. D. Israni, Advocate
		2. Amendments pertaining to Accounts & Audit	CA Himanshu Kishnadwala
		3. Important definitions Company Formation & Management & New Concepts like OPC, Small Company	Eminent Faculty

Sr. No.	Programme Name / Committee/Venue	Date/Subjects	Chairman/Speakers
		4. Important Amendments affecting Private Companies & unlisted Public Companies	CA Nilesh Vikamsey
		5. Provisions relating to BoD, Independent Directors (ID), Audit Committee, N & R Committee & other mandatory committee	*Dr. V. R. Narasimhan, Chief-Regulations National Stock Exchange of India Ltd.
		6. Merger & Acquisition	Shri Nitin Potdar, Solicitor
		7. Corporate Social Responsibilities (CSR)	*CA Anup Shah
		8. Company Law, 2013 vis-à-vis IFRS	*CA Jayant Gandhi
3.	**Direct Taxes Committee**		
A)	*The Dastur Essay Competition* (For Students of Law & Accountancy)	The Topics for Essay Competition (a) Ideal Education ….. What is required to be done? (b) Is Sports becoming Business and Business less Sporty? (c) Is Democratic Form of Government Best for India?	The essays can be send either by email on ctcessay@gmail.com or by physical delivery through post / courier at CTC office before 6 pm IST on 28th February, 2014. Participants are requested to confirm their participation by email on above said email id by 15th February, 2014. The Members are requested to encourage their Article Trainees and Law Students to participate in this competition For more details and the Rules, please visit website www.ctconline.org
B)	*8th Intensive Study Group (Direct Tax) Meeting* Venue – CTC Office	**20th February, 2014** Recent Important Decisions under Direct Taxes	Shri R. K. Sinha, Retd. IRS Officer

Sr. No.	*Programme Name / Committee/Venue*	*Date/Subjects*	*Chairman/Speakers*
4	**Indirect Taxes Committee**		
A)	*Workshop on MVAT Act & Allied Laws* (Jointly with STPAM, BCAS, AIFTP & WIRC of ICAI) Venue – Mazgaon Library, Vikrikar Bhavan, Mumbai	**15th February, 1st, 15th & 29th March; 5th & 19th April and & 3rd May, 2014** The topics selected for workshop are issue based and will cover MVAT Act, 2002, CST Act, 1956, Service Tax provisions and newly introduced provisions of LBT Act. These topics are of immense importance and will be of enormous and use to professionals practicing in Indirect Taxes (Two Jugal-bandi Lectures have been arranged in the month of February, 2014)	Shri Vinayak Patkar, Advocate Ms. Nikita Badheka, Advocate CA Rajiv Luthia Eminent Faculty CA Manish Gadia Shri Vidyadhar Apte, Advocate CA Jayesh Gogri CA Naresh Sheth Shri Deepak Bapat, Advocate Shri Kishor Lulla, Advocate
5	**International Taxation Committee**		
A)	*5th International Tax Conference* Venue – Hotel Sahara Star, Vile Parle	**28th February & 1st March, 2014**	
		1. Keynote Address	Senior official from CBDT
		2. Permanent Establishment – Emerging Issues including issues and Challenges in Digital Economy.	CA Geeta Jani
		3. GAAR – Issues and Challenges in Implementation (with Case studies impacting Inbound and Outbound Investments) and global developments concerning GAAR	Shri Kuntal Kumar Sen, IRS
		4. Transfer Pricing : Emerging Controversies and Challenges – Way Forward	CA Vispi Patel

Sr. No.	*Programme Name / Committee/Venue*	*Date/Subjects*	*Chairman/Speakers*
		5. Transfer Pricing structuring of Business Re-organisation and Issues	CA Sanjay Tolia
		6. Service Tax on Cross Border Transactions and Issues	CA A. R. Krishnan
		7. Emerging International Tax Trends and India's Tax Treaty Policy	CA T. P. Ostwal
		8. Case studies on International Taxation and Transfer Pricing – Panel Discussion	Panellist : Shri Sunil Lala, Advocate, Shri Kanchun Kaushal, Advocate and CA Pinakin Desai (Chairman)
B)	*Transfer Pricing Study Circle* Venue – Kilachand Hall, IMC	**The Period January 2014 to December 2014** The Study Circle is aimed at in-depth analysis of Law, Procedure and Jurisprudence with case studies	Mentors: Shri Samir Gandhi Shri Sanjay Tolia Ms. Karishma Phaterphekar
C)	Intensive Study Course on FEMA Venue – West End Hotel	**18th, 19th, 25th & 26th April, 2014**	
		1. Inaugural session	CA Manoj Shah
		2. Introduction and Overview of FEMA	CA Mayur Nayak CA Hinesh Doshi
		3. Important Definitions, structure of the Act, Rules and Regulations	Shri Ajit Shah CA Amit Purohit
		4. Entry strategy, Establishment of branch /project office by Non-residents in India	CA N. K. Hegde CA Naresh Ajwani CA Shabbir Motorwala
		5. Import and Export of Goods and Services	Shri Nishit Parikh CA Zulfiqur Shivji
		6. Bank Accounts and Deposit Regulations	RBI officials and eminent Faculties
		7. Borrowings and Leading in Rupees and Foreign Currency	

Sr. No.	Programme Name / Committee/Venue	Date/Subjects	Chairman/Speakers
		8. Investment in India of Immovable Property and outside India by Residents 9. Inbound Investment – Foreign Direct Investment – Schedule 1 10. Inbound Investment – Schedules 2 to 8 & investment in Partnership – Proprietorship concerns 11. Outbound Investment 12. Miscellaneous Remittances 13. Change in Residential Status under FEMA 14. Adjudication and Compounding of Contraventions 15. Case Studies on FEMA – A day-to-day Practice 16. Brain Trust	
D)	*4th Intensive Study Course on Transfer Pricing* (Including Domestic Transfer Pricing) ***24 Sessions – 6 Days*** Venue – West End Hotel	**8th & 22nd March, 2014 (Saturdays)** **4th & 5th April, 2014 (Friday & Saturday)** **11th & 12th April, 2014 (Friday & Saturday)** a) Basics of Transfer Pricing b) Benchmarking c) Industry Specific Sessions d) Key Controversy Areas – Recent TP Audit experience e) Practice Areas f) Other areas having TP implications	Eminent Speakers from the profession and revenue department: From the profession – Ms. Alpana Saxena, Amol Tibrewala, Ameya Kunte, Anis Chakraborty, Bipin Pawar, Darpan Mehta, Freddie Daruwala, Hasnain Shroff, Jigar Saiya, Karishma Phatarphekar, Kumar Sampat, Kuntal Kumar Sen, Milind Kothari, Sanjay Tolia, Samir Gandhi, Sudhir Nayak, Vaishali Mane, Vishwanath Kane, Vispi Patel, Waman Kale

Sr. No.	*Programme Name / Committee/Venue*	*Date/Subjects*	*Chairman/Speakers*
		g) Domestic Transfer Pricing h) The Road Ahead i) Attribution issues, experiences, recent rulings and Revenue's perspective j) Closing Session	From Revenue Department – C. S. Gulati
E)	*Intensive Study Group on International Taxation Meeting* Venue – CTC Conference Room	**The tentative dates for the next meetings are: 19th and 25th February, 4th, 11th and 20th March and 10th April, 2014** Taxation of Royalties – An In-Depth Study	To be finalised
6	**Residential Refresher Course & Public Relations Committee**		
A)	*37th Residential Refresher Course* Venue – Anandha Inn Convention Centre & Suites, Pondicherry	**13th February, 2014 to 16th February, 2014**	
		• Reassessments/Revision / Rectification	Paper Writer : CA Mahendra Sanghvi Chairman : Shri Keshav Bhujle, Advocate
		• Case Study under Direct Taxes	Paper Writer : Dr. Anita Sumanth, Advocate (Chennai) Chairman: Shri S. N. Inamdar, Sr. Advocate
		• Case Study in Taxation of Real Estate Transactions [Secs. 2(1A), 2(14), 43CA, 50C, 50D, 56(2)(vii)(b), 145 & TAS and 194-IA)	Paper Writer : CA Pradip Kapasi Brains Trustee : Shri Arvind Datar, Sr. Advocate (Chennai)
		• Brains' Trust : Direct Tax	Shri S. Rajaratnam, Sr. Advocate (Chennai)

Sr. No.	Programme Name / Committee/Venue	Date/Subjects	Chairman/Speakers
7	**Study Circle & Study Group Committee**		
A)	Study Circle Meetings	**24th February, 2014** i) Practical aspect of First Appeal before Income Tax authority and Art of presentation	Shri Ajay Singh, Advocate
		10th March, 2014 Issues u/ss. 45(3) and 45 (4)	Group Leader: CA Ashok Sharma Chairman: Shri Vipul Joshi, Advocate
B)	*Study Group Meetings* Venue : Babubhai Chinai Committee Room, IMC	21st February, 2014 Recent Judgments under Direct Taxes	CA Yogesh Thar
C)	*Study Circle on International Taxation Meeting* (Jointly with Intensive Study Group on International Taxation) Venue – Kilachand Hall, IMC	**16th January, 2014** Discussion of brief report on the UN Meeting of Committee of Experts on International Co-operation in Tax Matters (October, 2013) & Taxation of E-Commerce – Issues & Views	CA Nilesh Kapadia
8	**Amita Memorial Lecture Meeting jointly with BCAS** Venue – Walchand Hirachand Hall, IMC	**18th February, 2014** Spirit of Service : Connecting to the Inner-Net	Shri Nipun Mehta
9	**Delhi Chapter**		
	Study Circle Meeting Venue : to be announced	**21st February, 2014** Taxation of Foreign Remittances	To be announced

IV Forthcoming Journal by Journal Committee

The Chamber's Journal for the month of March, 2014 will cover topic on "Competition Commission and other Allied Laws".

V. Publications for Sale

A) International Taxation - A Compendium

Four hardbound volumes set containing approx. 4,000 pages.

(For Enrollment and further details of all the Future Events, please refer to the February, 2014 Issue of CITC News or visit the website www.ctconline.org)

INTERNATIONAL TAXATION COMMITTEE

Intensive Study Group on International Taxation Meeting held on 4th February, 2014 on the subject "Fundamental Principle of Royalty Taxation Historical development of Royalty taxation Source Rules in Act Source Rules under the treaties".

CA Rajesh L. Shah addressing the members.

CA Ganesh Rajgopalan addressing the members.

The Inaugural Meeting of Transfer Pricing Study Circle for the year 2014 held on 28th January, 2014 at Kilachand Hall, IMC.

CA Paresh P. Shah, Chairman welcoming the members. Seen from L to R : Shri Arun Saripalli, Co-ordinator, CA Vispi T. Patel, Faculty, CA Yatin Desai, President, CA Karishma Phatarphekar, Mentor, CA Vaishali Mane, Co-ordinator, CA Rajesh L. Shah, Convenor.

STUDY CIRCLE & STUDY GROUP COMMITTEE

Study Group Meeting held on 30th January, 2014 on the subject "Recent Judgments under Direct Taxes".

Shri Vipul Joshi, Advocate addressing the members.

Study Circle on International Taxation jointly with Intensive Study Group on International Taxation held on 16th January, 2014 on the subject "Brief report on the UN Meeting of Committee of Experts on International Co-operation in Tax Matters (October 2013) & Taxation of E-Commerce – Issues & Views".

CA Nilesh Kapadia addressing the members.

DIRECT TAXES COMMITTEE

7th Intensive Study Group (Direct Tax) Meeting held on 21st January, 2014 on the subject "Recent Important Decisions under Direct Taxes".

Shri Vinod Kumar Jain, Advocate addressing the members.

MEMBERSHIP & EOP COMMITTEE

Self Awareness Series held on 8th January, 2014 on the subject "Universality of Indian Culture".

CA Jawahar Baxi addressing the members.

The Marathon Meeting of Journal Committee held on 1st February, 2014 at West End Hotel.

Shri V. H. Patil, Chairman of Editorial Board addressing the members. Seen from L to R : CA Apurva Shah, Vice Chairman, CA Yatin Vyavaharkar, Chairman, CA Yatin Desai, President, Shri K. Gopal, Editor and CA Paras K. Salva, Vice President.

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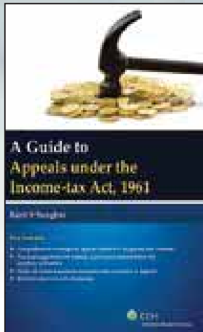

Title: A Guide to Appeals under the Income Tax Act, 1961
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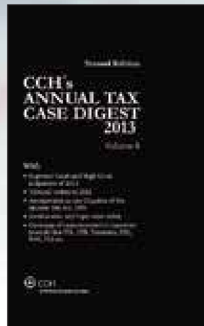
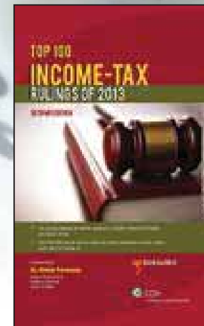


Title: CCH's Annual Tax Case Digest 2013, 2/e (2 Volumes)
By: CCH
ISBN: 9789351291244
Price: INR 2995/-

Title: Financial Reporting, Audit and Auditors as per Companies Act, 2013 (Including what has changed moving from the Companies Act, 1956 to the Companies Act, 2013)
By: CA. Sarika Gosain & CA. Rajesh Gosain
ISBN: 9789351291138
Price: INR 795/-



Title: Top 100 Income-tax Rulings of 2013, 2/e
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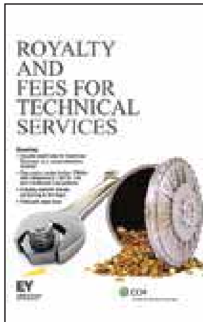
International Taxation



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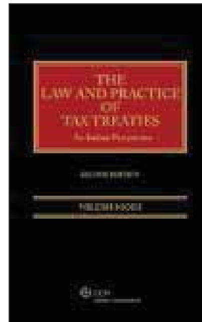

Title: The Law And Practice of Tax Treaties - An Indian Perspective 2/e and Updated edition
By: Nilesh Modi
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Price: INR 3995/-

Title: Worldwide Business Tax Guide, 4/e (3 Volumes)
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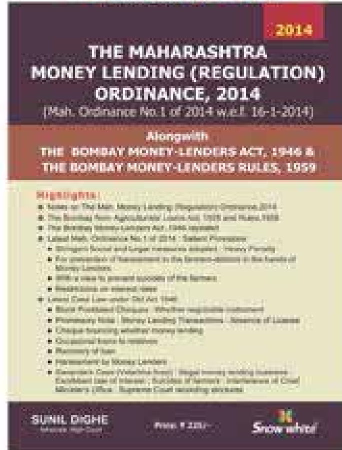
The Maharashtra Money Lending (Regulation) Ordinance, 2014



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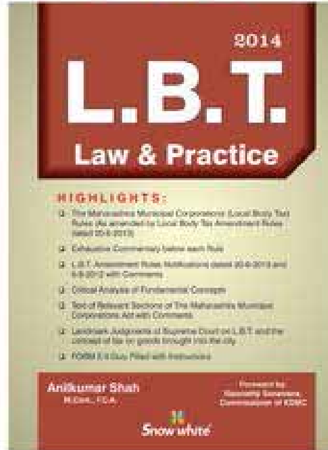

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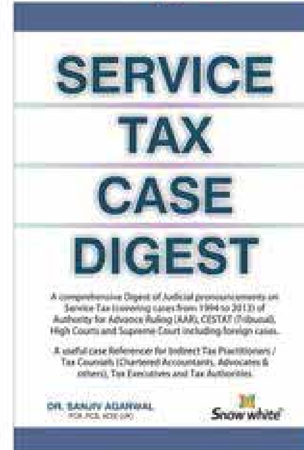

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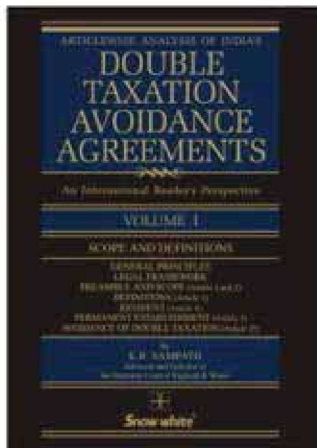

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