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The Chamber's Journal

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

October - 2016 Vol . V | No. 1

DEVELOPMENTS IN TRANSFER PRICING LAW

Direct Taxes
Other Laws
International Taxation

Other Contents

Indirect Taxes
The Chamber News
Best of the Rest
Corporate Laws
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One Team Mission

90TH YEAR CELEBRATION COMMITTEE

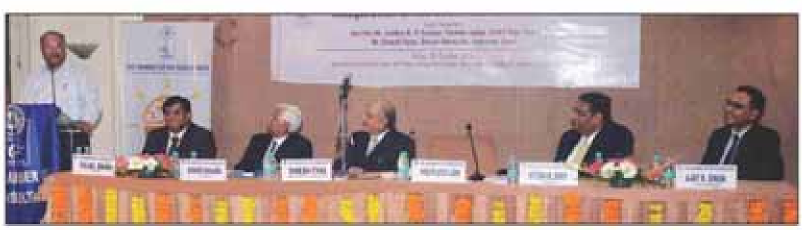
Inauguration function of "90th Year Celebration" held on 7th October, 2016 at IMC

CA Hitesh R. Shah, President delivering opening speech. Seen from L to R: CA Sujal Shah, Co-Chairman, Shri Kishor Vanjara, Chairman, Shri Dinesh Vyas, Senior Advocate, Supreme Court, Guest Speaker, Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court, Guest Speaker and Shri Ajay Singh, Vice President.

Shri Kishor Vanjara, Chairman delivering welcome address. Seen from L to R : CA Sujal Shah, Co-Chairman, Shri Dinesh Vyas, Senior Advocate, Supreme Court, Guest Speaker, Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court, Guest Speaker, CA Hitesh R. Shah, President and Shri Ajay Singh, Vice President.

Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court and Shri Dinesh Vyas, Senior Advocate, Supreme Court, Guest Speakers inaugurating the session by lighting the lamp. Seen from L to R: CA Sujal Shah, Co-Chairman, Shri Kishor Vanjara, Chairman, CA A. S. Merchant, Past President, Ms. Varsha Galvankar, Convenor, CA Hitesh R. Shah, President and Shri Ajay Singh, Vice President.

Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court launching The Chamber's Journal in electronic E-pub. Seen from L to R: CA Sujal Shah, Co-Chairman, Shri Kishor Vanjara, Chairman, Shri Dinesh Vyas, Senior Advocate, Supreme Court, Guest Speaker, CA Dinesh Tejwani, Vice Chairman, Student & IT Connect Committee, CA Hitesh R. Shah, President and Shri Ajay R. Singh, Vice President.



Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court addressing the member on the subject "Regulations through compliance: Loosing Woods for the Trees..." Seen from L to R : CA Sujal Shah, Co-Chairman, Shri Kishor Vanjara, Chairman, Shri Dinesh Vyas, Senior Advocate, Supreme Court, Guest Speaker, CA Hitesh R. Shah, President, Shri Ajay Singh, Vice President.

Shri Dinesh Vyas, Senior Advocate, Supreme Court addressing the members on the subject "Evergreen Field of Taxation............Challenges". Seen from L to R : CA Sujal Shah, Co-Chairman, Shri Kishor Vanjara, Chairman, Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court, Guest Speaker, CA Hitesh R. Shah, President, Shri Ajay Singh, Vice President.

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The Chamber of Tax Consultants
3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai – 400 020
Phone : 2200 1787 / 2209 0423 • Fax : 2200 2455
E-Mail: office@ctconline.org • Website : http://www.ctconline.org.

The Chamber's Journal

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Editorial

Wish you all a very happy Vijay Dashami. This month of issue of The Chamber's Journal will reach you when you have just got free from uploading the returns. The Hon'ble Finance Minister has expressed his satisfaction over the amount disclosed under the IDS, 2016. The solace drawn by the Hon'ble Finance Minister is on the basis that the disclosure under the scheme is much larger than the earlier schemes. But we would like to remind the Hon'ble Finance Minister that the amount disclosed under the scheme is nowhere close to the estimate of black money circulating in the economy within the country. We professional bodies have repeatedly represented before various forums that the disclosure schemes may generate revenue for the exchequer, but, they do not bring compliance. Voluntary compliance is possible only through creating effective deterrent. The Government had made the following statement before the Apex Court when the Constitutional validity of VDIS, 1997 was challenged *(All India Federation of Tax Practitioners vs. Union of India (1998) 231 ITR 24 (Supreme Court).*

"1. After 31st Dec., 1997, the IT Department will considerably step up survey operations under section 133A of the IT Act, 1961, and search operations under section 132 of the IT Act, 1961.

2. According to Chapter XIV-B of the IT Act as amended w.e.f. 1st Jan., 1997, if, in the course of a search, undisclosed income is detected, then the assessee is liable to the following:

   (i) Tax at the rate of 60 per cent;

   (ii) Penalty which can be up to 300 per cent on the tax evaded;

   (iii) Interest under section 158BFA.

3. In addition, the Finance Minister has announced that in every case of detection of undisclosed income, prosecution will be launched. The relevant provisions are in Chapter XXII of the IT Act.

4. Besides tightening up of legal provisions, the following steps have also been taken:

   (i) Acceleration of the process of issuing Permanent Account Number (PAN);

(ii) Acceleration of the computerisation of the IT Department;

(iii) Installation of software to detect assessees who satisfy the criteria laid down under the proviso to section 139(1) of the IT Act.

5. Government is committed to making a success of the VDIS-97 for fulfilling the objectives set by the Government in the Finance Minister's Budget Speech. We also wish to emphasise that section 72 of the VDIS-97 guarantees complete confidentiality in respect of declarations."

However, we have seen that the action was lacking on all the above counts. The parallel economy has expanded beyond anybody's imagination between the VDIS, 1997 and the present IDS, 2016. Thus, we again represent to the Government to create an effective deterrence by enforcing the tax laws in a transparent and judicious manner. Catch the tax-evader and take appropriate action against him. But, don't give license to the tax authorities to treat all the assessees as tax evaders. The trust deficit in the ordinary assessees' has to be removed. We do recognise that this Government has taken many steps towards infusing confidence in taxpayers. One them was creation of Simplification Committee under the Chairmanship of Hon'ble Justice Shri R. V. Easwar.

The Simplification Committee was in town on 8th of October, 2016. The Chamber of Tax Consultants along with other professional organisations has made representation before the Committee. We are optimistic that our representation will be considered favourably by the Committee.

The Special Story of this issue of Chamber's Journal is on "Developments in Transfer Pricing Law." The Special Story has been designed and scheduled in such a manner that it shall come in handy to all the readers. I thank all the esteemed professionals, who have contributed to this issue of The Chamber's Journal.

K. GOPAL
Editor

"Thinking should become your capital asset, no matter whatever ups and downs you come across in your life."

— *A. P. J. Abdul Kalam*

From the President

Dear Members,

Wish you all Happy **Navratri**. Generally October brings relief and festivities, especially for the Professionals engaged in audit and filing of tax returns. This year the time limit has been extended for audit and filing return to 17-10-2016, which eased out some pressure on professionals.

In the month of September 2016, **Union Cabinet approved three major changes to the Annual Budget process i.e. advancement of presentation of Union Budget by 27 days, to do away with a separate Railway Budget and to dispense with plan and non-plan dichotomy in expenditure.** These are welcome steps. Budget reform has to go further to incorporate a multi-year time horizon and shift to outcome-linked expenditure management as had been recommended by a committee headed by Shri C Rangarajan in 2011.

Advancing the presentation of the budget will now allow Parliament to vote on tax, finalise spending proposals before the beginning of the new financial year on April 1 and direct tax measures to have full year's play.

Merger of standalone railway budget with the general budget after 92 years, will give combined view of Government finances instead of fragmented view. In my view, it may be worthwhile to explore corporatisation of the Railways at this juncture instead of it being a part of Government wing.

There is an urgent need to improve accounting systems in railways. At present, even experts appointed by Government struggle to arrive at the true cost of providing services. An independent regulator, with access to an improved railway accounting system will benefit both consumers and the service provider.

The distinction between the plan and non-plan had become dysfunctional and expenditure will now be classified as revenue (current)/or capital.

In this context, it is important to keep in mind that the budgetary process changes are effective only when they are complemented by other steps or reforms.

Government has received **largest-ever declaration of black money, ` 65,250 crore** as unaccounted income and assets under **Income Declaration Scheme (IDS) 2016** which ended on 30-9-2016. It is likely to get tax revenue of ` 29,362 crores .The figure is likely to go upward once declarations are verified and tabulated. Last year, under a similar scheme for foreign black money holders, 644 declarations of undisclosed foreign income and assets were received, and just about ` 2,428 crore was collected in taxes. This has resulted in more declared income brought into the economy. **Still declaration is minimal as compared to black money expected to be prevailing in systems. As per the study India's black economy is pegged at over ` 30 lakh crore or about 20% of total GDP. Government needs to put more efforts and more machineries to bring more and more people under tax net . It is now a time to focus on unearthing undisclosed income who are not at all filing return of income rather than only concentrating only on assessees who are already under Tax net.**

In the first week of October 2016, **RBI announced 0.25% cut in interest rate** (repo rate), which has surprised many by sudden shift in RBI policy and **softening stance on inflation** target and real interest rates. It appears that growth is now bigger worry than Inflation. Such move will definitely reduce the cost of funding of businesses though benefits of such reduction may not be passed on immediately by banks looking at the higher NPA. However it has come at a time where the risk of upward inflation is looming large

For the first time the policy decision was put to vote by a monetary policy committee comprising of three nominees from RBI and three from Government which till now was always the domain of the RBI Governor.

The Chamber had organised Workshop on GST model laws in the month of September 2016 and the Delhi Chapter of Chamber also organised programme on Mergers, Acquisition and Corporate restructuring which were very educative in nature.

The Chamber commemorated its 90th year on 7th of October 2016. It was great moment for everyone present there to hear the distinguished speakers **Hon'ble Shri Justice R. V. Easwar, Former Judge of Delhi High Court,** and also **Shri Dinesh Vyas, Senior Advocate** who while sharing their life experiences advised professionals to follow principles and without being afraid of anything follow what one feels is morally right. I compliment 90th year Celebration Committee, which worked very hard to organise the said programme.

During that historic moment, by the worthy hands of Shri R. V. Easwar Chamber also inaugurated its monthly journal on IPAD, Mobile or any electronic gadgets. Now readers can download the same from the website of the Chamber and can read on their electronic gadgets at their convenience. I compliment Chairman of Journal Committee Shri Vipul Choksi for this initiative and Vice Chairman of Student and Information Technology Committee Shri Dinesh Tejwani and his team working hard in achieving this milestone in the history of Chamber.

The Chamber has already introduced mobile for its core group directory. The Chamber is in process of digital transformation and I am sure time is not far where the chamber will be able to deliver its programs to each and every members wherever they are located.

Chamber has also planned various unique programmes including workshops such as Orientation Course on FEMA, Inbound Investments & exit strategy (by Delhi Chapter), Search and Survey Programme at Vapi, Certificate Training Course in IND AS, Surveys under Income tax and TDS Survey, Alternative Fund raising Options for Corporates, Insider Trading Direct Tax RRC and Indirect Tax RRC with unique features and well reputed speakers. **I suggest the members to keep tab on the programmes of the Chamber to avail the benefits of such programmes.**

Keeping its momentum on for representation before various statutory authorities, Indirect Tax Committee had filed representation before the Commissioner of VAT Maharashtra seeking extension of time limit for filing of Form No. 501 by 30-9-2016 due to technical snag in filing online form and time limit was finally extended up to 8-10-2016.

Further Law and Representation Committee under the Chairmanship of Shri Mahendra Sanghvi along with Chairman of International Tax Committee Shri Paresh Shah made **a detailed representation before the Tax Simplification Committee chaired by Hon'ble Shri Justice R. V. Easwar, Former Judge of Delhi High Court** on 8-10-2016 at IMC. Such representation is a mammoth task and committee has whole-heartedly worked on the same. **The Committee prepared an exhaustive booklet which was appreciated by the Tax Simplification Committee.** I compliment both the Chairman and also all members who worked hard to make said representation. The representation is available on the website of Chamber. Chamber is in the process of making pre budget representation, members are requested to send proposals to Chamber through e-mail.

I would like to mention that Office Bearers (OBs) are supportive in executing Chamber's work. All OBs are excited for weekly morning meetings despite work pressure and also relish the morning breakfast, this reminds me of the earlier days when I joined as office bearer.

As we all know transfer pricing audit will be required to be completed by end of November 2016, hence timely issue of Chamber's Journal for the month on 'Developments in Transfer Pricing Law' will be very useful to all. It has been designed very well and deserves appreciation. **The growth of globalisation and resultant cross-border transactions has opened up possibilities of transfer pricing abuse.** The transfer pricing regulations were introduced under the Income-tax Act to protect tax base. The issue deals with Transfer pricing provisions, future of transfer pricing, bench marking of transaction, and controversies in Transfer pricing. I am confident that the Readers will immensely benefit from the same.

At the end, it is painful to learn that 18 brave hearts of Indian Army sacrificed their lives in service of the nation during latest terrorist attack in Uri in J & K. **Chamber salutes them and pays homage to the martyrs.**

I wish all the readers a very happy Dussehra and Diwali !

HITESH R. SHAH
President

Chairman's Communication

Dear Readers,

Surgical strikes by the Indian Army in Pakistan occupied Kashmir on 28th/29th September have become a matter of public discourse not only in India but the world over! So much so that the Prime Minister had to ask his colleagues to ease up on jingoism. The media coverage of the surgical strike overshadowed the success of the Income Declaration Scheme, 2016 which got over on 30th September and the Government has succeeded in getting declaration of about ` 65,000 crore under this scheme. The final outcome of the declarations was much higher than the initial estimate and was the result of sustained media campaign, action by tax officials etc. Though, it is highly debatable point whether the IDS, 2016 was really a success. It is estimated that there will be additional revenue of ` 30,000 crore in the Government coffer.

Rotation of auditors under the Companies Act, 2013 will be effective after March, 2017 and therefore many of the Indian Accounting Firms which have been the statutory auditors of various companies for decades would retire. However they may not in turn get appointed as Statutory Auditors in other companies due to various reasons. Thus the auditing profession is passing through a challenging phase. Thankfully, the Ministry of Corporate Affairs has constituted an expert group to examine and give recommendations on various issues relating to appointment of auditors. This is possibly a silver lining and something positive may come out which would help the Indian Accounting Firms.

The deadline for filing of Tax Audit Reports and Tax Returns would have been over by the time you receive this issue. Many of you would be now gearing up to do the transfer pricing audits and of course the transfer pricing assessments also are on. Transfer pricing is an ever evolving subject and we thought that this would be the right time to bring the issue on Transfer Pricing. My colleagues in the Journal Committee, Vice Chairman, Bhadresh Doshi, Paras K. Savla, Kreethiga Shrama and Dharan Gandhi have put in lot of efforts in making the design and identifying the authors. Convenor, Toral Shah too has put in lot of effort for the design, identifying authors and overall co-ordination of the issue. Appreciation for efforts of all them. I am sure you would find this issue useful and would be benefitted by the same.

The authors invited to write the articles have expert knowledge on the subject. I thank and compliment all of them for sparing their valuable time and sharing their knowledge despite their busy schedule.

Wishing you and your family a Very Happy Deepawali and Prosperous New Year !

VIPUL K. CHOKSI
Chairman – Journal Committee

CA Vispi T. Patel & CA Kejal Visharia

Section 92 – Applicability of Transfer Pricing Provisions

Introduction

India is emerging as one of the favoured destinations for global players. Prior to 1991, India was a highly regulated economy. Since then, the objective of the Government has been to build a modern democratic, socialist, prosperous, and forward looking India, maintain a sustained growth in productivity, create gainful employment, and attain international competitiveness. In this regard, one of the initiatives is to promote foreign investment and technical collaborations to bring attendant advantages of technology transfer and marketing expertise.

The Indian economy has become the fastest growing major economy in the world as its GDP grew 7.6% in 2015-16 compared to 7.2% in 2014-15 largely driven by growth in private consumption due to low oil prices and higher real income. Inflation was well within budgeted levels at 5% and is expected to be within controllable levels. Indian economic outlook is very strong as rising infrastructure spending, commitment to fiscal targets, forecast of above normal rainfall and Government's focus on "Make in India" and "Start-up in India" campaigns is likely to boost growth. Real GDP growth for 2016-17 is estimated at 7.6%.[1]

Recently, India had the biggest leap in ranking for any country in the World Economic Forum's (WEF) global competitiveness index[2]; in the 2016-17 rankings, India's rank has jumped to the 39th position and it is now the second most competitive BRICS[3] economy[4].

The engine of this growth can be traced to India's leading position in the business process outsourcing and information technology sectors. As multinational enterprises (MNEs) realise the economic advantages, availability of human talent and business synergies of outsourcing, they are investing in India.

The increased foreign investment and integration of India into the global economy has resulted in various business models being implemented by the MNEs, which in essence may be valuable propositions for their organisation, but could be diametrically opposed to the revenue authorities' perspective of source-based taxation. However, the tax authorities are apprehensive that the growth in globalisation and resultant cross-border transactions have opened up possibilities

1 Source: RBI: Monetary Policy Report dated April 5, 2016

2 http://www3.weforum.org/docs/Media/GCR1617/GCR_16.pdf

3 Brazil, Russia, India, China and South Africa

4 http://indianexpress.com/article/business/economy/global-competitiveness-index-india-jumps-16-ranks-for-second-time-second-most-competitive-brics-economy/

of transfer pricing abuse. Consequently, to protect the tax base, the tax authorities felt the need to have an appropriate transfer pricing regulation in place.

Indian transfer pricing regulations (TPR) were legislated in 2001, effective from assessment year (AY) 2002-03, after considering regulations of several countries and the Organization for Economic Co-operation and Development's (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The transfer pricing legislation gave India's tax authorities broad powers to impose penalties for wilful negligence in setting prices and for failing to maintain documentation.

Before the advent of the detailed transfer pricing regulations in India in 2001, the old law as regards certain type of cross-border transactions between residents of India and non-residents is discussed below. This will help us to understand the evolution of transfer pricing law in India.

Old law of Income-tax Act, 1922

Section 42(2) of the Income-tax Act, 1922 (IT Act, 1922) states as under:

"Where a person not resident [or not ordinarily resident] in [the taxable territories] carries on business with a person resident in [the taxable territories], and it appears to the Income-tax Officer that owing to the close connection [between such persons the course of business is so arranged that the business done by the resident person with the person not resident or not ordinarily resident] produces to the resident either no profits or less than the ordinary profits which might be expected to arise in that business, the profits derived therefrom or which may reasonably be deemed to have been derived therefrom, shall be chargeable to income-tax in the name of the resident person who shall be deemed to be, for all the purposes of this Act, the assessee in respect of such income-tax."

The section can be analysed as under:

- There is a resident and a non-resident/not ordinarily resident.
- There is close connection.
- Non-resident/not ordinarily resident is regarded as carrying business with a resident.
- The subject of charge is the "business."
- What is taxed is "the profits derived there from or which may be reasonably be deemed to have been derived there from."
- The use of the phrase "therefrom" connotes the meaning business of the resident and the non-resident/not ordinarily resident.
- In these circumstances the Income-tax officer is empowered to make adjustments in case of the resident by redetermining income which may reasonably be deemed to have been derived there from, i.e., from the business between such resident and non-resident/not ordinarily resident.

Section 42(2) of the IT Act, 1922 recognised the well-established arm's length principle, though indirectly, in determining taxable profits of resident. Here, the profits subject to tax were not the ones earned and shown in the books but these were profits that could have been expected to be earned from such business. This can be clearly understood from the decision of the Hon'ble Supreme Court in the case of *Mazagaon Dock Ltd vs. CIT & EPT*.[5] The decision makes it clear that under the IT Act, 1922, the arm's length principle is indirectly recognised in determining taxable profits of a resident. A resident enterprise as such could be taxed in respect of profits which it would have normally made but for its business arrangement with the non-resident/not ordinarily resident.

5 Mazagaon Dock Ltd. vs. CIT & EPT (1958) 34 ITR 368 (SC)

Section 92 of the Income-tax Act 1961 (prior to amendment)

Section 92 of the Income-tax 1961 Act (IT Act, 1961) as it stood before its amendment in 2001 incorporated special provisions relating to avoidance of tax and cross-border transactions. This section was in line with section 42(2) of the IT Act, 1922 and tried to deal with the practice of "parking profits" in an off-shore tax haven.

The provision remained unamended on statute for several years as it was an anti-avoidance provision and there were hardly any transfer pricing issues in that period because India had a closed economy and few international transactions between related entities.

Section 92 of IT Act, 1961 as it stood prior to amendment reads as under:

"Where business is carried on between a resident and a non-resident and it appears to the Assessing Officer that, owing to the close connection between them, the course of business is so arranged that the business transacted between them produces to the resident either no profits or less than ordinary profits which might be expected to arise in that business, the Assessing Officer shall determine the amount of profits which may reasonably be deemed to have been derived there from and include such amount in the total income of the resident"

The erstwhile section 92 applied in case of business income and aimed at reconstructing profits rather than income or expenditure. The matter of concern was computation of business profits and not the arm's length price of the transaction, that is, the arm's length principle was not explicitly used in this section. The section also failed to address various shortcomings; for example; it failed to define the term "close connection." Further, where a taxpayer entered into several transactions it was difficult to apportion expenses to each of them and arrive at the profit.

Section 92 of the Income-tax Act 1961 (post amendment)

India needed to strengthen the statutory law to deal with challenges posed by the term "transfer price." In November 1999, the Government formed the Expert Group under the chairmanship of Mr. Raj Narain, to suggest the framework for the TPR.[6] The recommendations of the Expert Group formed the foundation for the introduction of a comprehensive legislation via the Finance Act, 2001. The then existing section 92 was omitted and new sections 92 to 92F containing the TPR were introduced in the IT Act, 1961. In addition, the CBDT also inserted Rules 10A, 10B, 10C, 10D and 10E in the Income-tax Rules, 1962 (the Rules) complementing the TPR.

The Finance Bill, 2001's explanatory memorandum stated that the legislation dealing with transfer pricing was introduced to curb transfer pricing abuse. The memorandum further stated that:

"......the increasing participation of multinational groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, thereby, leading to erosion of tax revenues. With a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises, new provisions are proposed to be introduced in the Income-tax Act.

6 Mr Yashwant Sinha, former Finance Minister, Government of India in his speech dated February 28, 2001 provided rationale for introducing the TPR:
"The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions has made the issue of transfer pricing a matter of serious concern. I had set up an Expert Group in November 1999 to examine the detailed structure for transfer pricing legislation. Necessary legislative changes are being made in the Finance Bill based on these recommendations."

The regulations attempt to create a simple and equitable law. They aim to provide a statutory framework that will create a reasonable, fair, and equitable tax base and prevent abuse of transfer pricing in regard to cross-border transactions between associated enterprises."

The Central Board of Direct Taxes (CBDT) issued Circular No. 12 of 2001[7] dated August 23, 2001 ('Circular 12'), which clarifies some key provisions governing transfer pricing in India. Further, the CBDT *vide* Circular No. 14 of 2001 dated November 9, 2001[8] issued a circular explaining the provisions of the Finance Act, 2001, whereby Para 55 of the said Circular lays down the rationale for introduction of the TPR, intention of the TPR and explains the provisions of the TPR.

The provisions of Chapter X of the IT Act, 1961 are constitutionally valid and within the legislative competence of the Parliament. The Hon'ble Punjab and Haryana HC in the case of Coca Cola India Inc[9] upheld the Constitutional validity of Chapter X of the IT Act, 1961. It held that the separate treatment for international transactions between associated enterprises does not violate Article 14 of the Constitution of India.

Applicability of transfer pricing provisions where no income accrues or arises to an assessee

Section 92(1) of the IT Act, 1961 provides for arm's length computation of any "income" arising from an international transaction and any expense or interest arising in connection thereto.

Section 92 of the IT Act, 1961 lays down that:

– any income

– arising from an international transaction

– shall be computed

– having regard to

– the arm's length price

Concept of Income

The concept of "income" is present under the provisions of IT Act, 1961 since the inception of the statute and even beyond, i.e., since the old income-tax law in India in form of the IT Act, 1922. The question is whether the introduction of transfer pricing provisions since 2001 have diluted this concept of 'income' as understood and interpreted in jurisprudence.

"What is the object of the Income-tax Act?" Simply put, it is a legislation to impose a liability of tax upon a person in respect of his income. To simplify matters, the total amount of income for a year is computed and the charge of income-tax is created on such total income, under the respective heads of income under section 14 of the IT Act, 1961. Yet, what is chargeable to tax is only "income." To iron-out any difficulty in proper appreciation of "income," the concept of real income needs to be reiterated.

Section 4 of the IT Act, 1961 provides that the charge of income tax shall be in respect of total income of an assessee. Further, as per section 5 of the IT Act, 1961 the scope of total income includes any income that is accrued / received and deemed to have been accrued / received.

The Hon'ble SC justified this concept in the case of Shoorji Vallabhdas & Co.[10] holding as under:

"Income-tax is a levy on income. No doubt, the Income-tax Act takes into account two points of time at which the liability to tax is attracted, via the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a hypothetical income, which does not materialise. Where income

7 http://www.incometaxindia.gov.in/Communications/Circular/910110000000000505.htm

8 http://www.incometaxindia.gov.in/Communications/Circular/Others/910110000000000731/financeact2001_rate.htm

9 Coca Cola India Inc vs. ACIT [(2009) 309 ITR 194 (P&H)]

10 CIT v. Shoorji Vallabhdas & Co. [(1962) 46 ITR 144 (SC)]

has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account."

Certainty of realisation

In the case of UCO Bank,[11] it was held that contractual terms by themselves would not result in accrual of income and that an emphasis must be laid on "certainty" of realisation. A similar view is taken in the case of Godhra Electricity Co. Ltd.[12] wherein the Hon'ble Supreme Court held that no real income accrued to the assessee as the assessee was not in a position to recover any amount from the consumers and therefore the income, if any, did not represent real income. Further, the Delhi HC in the case of Devsons (P) Ltd.[13] held that where the service recipient disputes the invoice or part of the invoice raised by the service provider, no income accrues to the service provider in so far as the dispute is concerned.

The term "received" referred to in section 5 of the IT Act, 1961, is the place of first receipt of the income by the taxpayer or his agent. Subsequent, remittance of such amount to India would not make that amount as "income" exigible to tax in India. Reference in this regard may be made to the decision of the Hon'ble Supreme Court in the case of Keshav Mills,[14] wherein the Apex Court held that the words used in section 4(1)(a) of IT Act, 1922 (corresponding to section 5(2)(a) of the IT Act, 1961), relate to the first receipt after the accrual of income. Once it is received by the party entitled to it, in respect of any subsequent dealing with the said amount, it cannot be said to be "received" as income on that occasion.

Issues with respect to transfer pricing

Provision of corporate guarantee by Indian parent to its subsidiary without any charge

In respect of corporate guarantee provided by an Indian parent company to its foreign subsidiary company without any charge, several tribunal decisions have held that there can be no basis for levying tax on a notional basis and have held that a corporate guarantee is not an international transaction, albeit on a different basis as discussed below:

– Provision of a corporate guarantee would not constitute an international transaction unless the same has a bearing on the profits, income, losses or assets of the taxpayer or involves any cost.

– When the issuance of corporate guarantee is in the nature of quasi-capital or shareholder activity, it does not amount to a service.

– Explanation to section 92B enlarges the scope of definition of "international transaction" and accordingly, cannot be said to be retrospective in effect.

The Mumbai Tribunal in the case of Manugraph India Ltd.[15] and Siro Clinpharm Private Limited[16] have stated that there was a subtle difference in the words "impact on" and "influence on." The corporate guarantee may have "an influence" on the profits, income, losses or assets of the beneficiary entity in whose favour such guarantee was issued, but it has "no impact" on the same as long as it was issued without consideration. Further, while analysing corporate

11 UCO Bank vs. CIT [(1999) 237 ITR 889 (SC)]
12 Godhra Electricity Co. Ltd. vs. CIT [(1997) 225 ITR 746 SC]
13 CIT vs. Devsons (P) Ltd [(2010) 329 ITR 483 (Delhi)]
14 Keshav Mills vs. CIT [(1953) 23 ITR 230 (SC)]
15 Manugraph India Ltd vs. DCIT [2016-TII-249-ITAT-MUM-TP]
16 Siro Clinpharm Private Limited vs. DCIT [ITA No. 2618/Mum/2014]

guarantees, several aspects would need to be considered, such as nature of guarantee provided (financial or performance).

The Mumbai Tribunal in the above cases has drawn a distinction from cases where the taxpayers themselves had charged guarantee commission such as in the case of Everest Kanto Cylinders Ltd[17] and Advanta India Limited.[18] Further, in such cases, the guarantees clearly had an impact on the profits of the taxpayer. Accordingly, the issue of whether the same constitutes an international transaction did not arise or come up for adjudication.

The Ahmedabad Tribunal in the case of Micro Inks[19] held that a corporate guarantee issued for the benefit of its subsidiaries, not involving any cost to the holding company and not having any bearing on profits, income, losses or assets of the holding company, is outside the ambit of "international transaction." The Tribunal came to this conclusion on the basis of the opening words of the Explanation added by the 2012 Amendment *"for the removal of doubts."* As the Explanation is only intended to be clarificatory in nature, the Tribunal held that the Explanation is required to be read harmoniously with the main provisions and cannot alter the basic character of the definition of "international transaction" prior to the 2012 Amendment.

Further, the Ahmedabad Tribunal held that such transactions can qualify as an "international transaction" only if they have a *"bearing on the profits, income, losses or assets of such enterprises."* Such "bearing" or impact may happen in the future, but would not cover situations where the impact is contingent. The Tribunal also referred to the decisions of Delhi Tribunal in the case of Bharti Airtel Ltd.,[20] Chennai Tribunal in the case of Redington (India) Ltd.[21] and Mumbai Tribunal in the case of Videocon Industries Ltd.[22]

The Tribunal also held that the guarantees were in the nature of shareholder activity / quasi-capital and do not qualify as "international transactions." It also held that the "provision of services" is restricted to services rendered and it does not extend to the benefits of activities per se. Similar view has been upheld by the Mumbai Tribunal in the case of Manugraph India Ltd. (supra).

Interest free loan granted between group companies

There are various decisions which state that based on Chapter X of the IT Act, 1961, being an anti tax avoidance measure, even in cases where no interest is charged, interest can be attributed to the (assessee) company.

The Ahmedabad ITAT in the case of Micro Inks Ltd.[23] has discussed the issue of provision of interest-free loans being treated as quasi-equity. The Tribunal has clearly differentiated the facts of this case from the prior rulings (i.e. VVF Ltd.[24]. and Perot Systems[25]) thereby laying down a principle that in cases where the taxpayer infuses money in the form of loan, against the backdrop of regulatory restrictions, it is the function, asset and risk analysis of the transaction, that needs to be appreciated. The ITAT has carefully considered the nature of commercial considerations, terms of loans, business arrangement, etc. while pronouncing the decision.

There are decisions which state that interest is to be charged and have brushed aside the argument of notional income, e.g., in the case of Perot Systems (supra) the Tribunal has brushed aside the proposition that only the real income

17 Everest Kanto Cylinders Ltd vs. DCIT {[34 taxmann.com 19 (Mumbai)] = 2012-TII-145-ITAT-MUM-TP}
18 Advanta India Limited vs. ACIT [(2015) TII-294-ITAT-BAN]
19 Micro Ink vs. ACIT [2015-TII-520-ITAT-AHM-TP]
20 Bharti Airtel Ltd vs. ACIT (ITA No. 5816/ Del/ 2012)
21 Redington (India) Ltd vs JCIT (ITA No. 513/Mds/2014)]
22 M/s. Videocon Industries Ltd. vs. ACIT [ITA No. 6145/MUM/2012, 1728/MUM/2014 and 1729/MUM/2014]
23 Micro Ink vs. ACIT [(2016) 176 TTJ 8 (Ahd)] = 2015-TII-520-ITAT-AHM-TP
24 VVF Ltd. vs. DCIT (ITA No.673/Mum/2006) = 2010-TII-04-ITAT-MUM-TP
25 Perot Systems TSI (India) Ltd. vs. DOIT - 2010-TIOL-51-ITAT-DEL = 2010-TII-03-ITAT-DEL-TP

has to be taxed and interest free advances can be given by companies (domestic) to their subsidiaries on the ground of commercial expediency, stating that the decisions of Apex Court are not in the context of Chapter X of the IT Act, 1961, which relates to special provision relating to computation of income from international transactions having regard to arm's length price.

Further, in the case of Vodafone India Services Pvt. Ltd.,[26] the Hon'ble Bombay High Court (HC) did not accept the Revenue's contention that in view of Chapter X of the IT Act, 1961, the notional income is to be brought to tax and real income will have no place. However, the decision was rendered in the case of lower share premium being received by the Indian subsidiary from its parent and the HC held that it being a capital account transaction has no relevance to income and therefore, Chapter X of the IT Act, 1961 would not apply.

Thus, it will be interesting to see how jurisprudence evolves as regards the basic philosophy of the TPR. The fundamental question would be whether the concept of "real income" as enunciated by various decisions of the Apex Court needs to be understood differently, or is it watered down while interpreting Chapter X?; if so, whether the purport of the charge of income-tax as provided under section 4 and section 5 of the IT Act, 1961 changes colour when the issue at hand requires evaluation of arm's length price of the international transaction.

Section 92 of the IT Act, 1961 – Charging section or machinery section?

Section 92(1) of the IT Act, 1961 contains the terms "shall be computed" which raises another issue as to whether the transfer pricing provisions are charging provisions or machinery provisions?

The intention of the legislature in a taxation statute is to be gathered from the language of the provisions particularly where the language is plain and unambiguous. In a taxing Act, it is not possible to assume any intention or governing purpose of the statute more that what is stated in the plain language. It is not the economic results sought to be obtained by making the provision which is relevant in interpreting a fiscal statute.

Words cannot be added to or substituted so as to give a meaning to the statute which will serve the spirit and intention of the legislature. The statute should clearly and unambiguously convey the three components of the tax law, i.e., the subject of the tax, the person who is liable to pay the tax and the rate at which the tax is to be paid. If there is any ambiguity regarding any of these ingredients in a taxation statute then there is no tax chargeable in law. Then, it is for the legislature to do the needful in the matter.[27]

The general arrangement of the provisions in the Income-tax Act is that under each head of income the charging provision is accompanied by a set of provisions for computing the income subject to that charge. The character of the computation provisions in each case bears a relationship to the nature of the charge. Thus, the charging section and the computation provisions together constitute an integrated code.[28]

The rule of construction of a charging section is that before taxing any person, it must be shown that he falls within the ambit of the charging section by clear words used in the section.[29]

The Authority for Advance Rulings (AAR) has delivered rulings in the case of Vanenburg Group B.V.[30], Dana Corporation[31] and Amiantit International Holding Ltd.,[32] wherein it was held

26 Vodafone India Services Pvt. Ltd. vs. Union of India and Others (Writ Petition No 871 of 2014)

27 Mathuram Agarwal [1999 (8) SCC 667 (SC)]

28 B. C. Srinivasa Setty [(1981) 2 SCC 460 (SC)]

29 CWT vs. Ellis Bridge [(1998) 229 ITR 1 (SC)]

30 Vanenburg Group B.V. [AAR No.727 of 2006 dated January 1, 2007]

31 Dana Corporation [AAR No. 788 of 2008 dated November 30, 2009]

32 Amiantit International Holding Ltd. [(2010) 322 ITR 678 (AAR)]

that sections 92 to 92F are special provisions relating to avoidance of tax. These are again machinery provisions which would not apply in the absence of liability to pay tax.

Further, the AAR in the case of Good Year Tire and Rubber Company,[33] also held that, *"as there is no income liable to tax in the hands of the applicant, the provision of sections 92 to 92F of the Act will not be applicable and the transfer pricing provision in Chapter X are not attracted."*

Further, unlike the above AAR rulings, the AAR in the case of Castleton Investment Limited[34] (applicant), held that the provisions pertaining to transfer pricing and filing of return of income are applicable even if the income (capital gains) is not liable to tax. The facts of the said case were that Castleton, a company incorporated in Mauritius, held shares in an Indian listed company. Further, applicant proposed to transfer its investment in the Indian Co. at fair value to an associated enterprise in Singapore, through an off market transaction. One of the key issues raised before the AAR was that will transfer pricing provisions be applicable, even if the transfer of shares by the applicant to Singapore AE was not taxable in India?

The AAR further held that section 92 to section 92F of the IT Act, 1961 are machinery provisions and hence, capital gains cannot be determined without resorting to them. Only on determining whether capital gains have arisen, the question of chargeability would arise. Therefore, whether ultimately the gain or income is taxable in the country or not, sections 92 to 92F of the IT Act, 1961 would apply if the transaction is one coming within the provisions. Applicability of section 92 does not depend on chargeability under the IT Act, 1961. The AAR further held that where there is no liability, the purpose of undertaking a transfer pricing exercise is not a question that would affect the operation of a statutory provision. Therefore, the AAR held that transfer pricing provisions would be applicable in the said case.

The Hon'ble HC in the case of Vodafone (supra) concluded that Chapter X of the Act is a machinery provision to arrive at the ALP of a transaction between associated enterprises (AEs).

The AAR rulings are binding on the taxpayer as well as the revenue authorities and have a persuasive value in similar cases. However, since AAR rulings are specific to a particular case, they cannot serve as precedents like court judgments. Further, based on the above rulings and decisions, where it is established that the transaction is not subject to tax in India (under the provisions of the Act/ double taxation avoidance agreement), the provisions of Chapter X of the IT Act, 1961 would not be applicable seems to be a better view.

Arm's Length Price

Section 92F(ii) of the IT Act, 1961 lays down that:

'arm's length price means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions'

Thus, the concept of arm's length price (ALP) has been defined as any price which is charged / paid by unrelated parties acting under uncontrolled conditions, i.e. the circumstances surrounding the transactions should be such that two independent third parties would enter into such transactions at the agreed price. It is pertinent to lay emphasis on the conditions and circumstances which would lead two independent third parties to negotiate and arrive at that agreed price, called as the arm's length price.

Burden of Proof – Revenue or Taxpayer?

Section 92(1) of the IT Act, 1961 lays down that:

'Any income arising from an international transaction shall be computed having regard to the arm's length price.

Explanation – For the removal of doubts, it is hereby clarified that the allowance for any expense or interest arising from an international transaction shall also be determined having regard to the arm's length price.

The primary onus is on the taxpayer to determine an ALP in accordance with the Indian TPR and to substantiate the same with the prescribed documentation which the taxpayer is required to maintain and demonstrate the adherence to the arm's length price by selection and application of the most appropriate method. Where such onus is discharged by the taxpayer and the data used for determining the ALP is reliable and correct there can be no intervention by the tax officer.

33 Good Year Tire and Rubber Company [(2011) 334 ITR 69 (AAR)]

34 Castleton Investment Limited [AAR No. 999 of 2010 dated August 14, 2012]

However in cases, where the tax officer is of the view that the taxpayer has failed to furnish any satisfactory information or documentation as required to be furnished under the Indian TPR or such information or document is inadequate, the burden shifts to the tax officer and he may reject the ALP adopted by the taxpayer and determine the ALP in accordance with the TPR. This is also brought out by the provisions of section 92C(3) of the IT Act, 1961.

Applicability of transfer pricing provisions in case of transactions with a permanent establishment (PE) taxable in India

Transfer Pricing provisions are applicable for international transactions between two or more associated enterprises and for that purpose, the definition of "enterprise" needs to be satisfied first. The relevant extract of section 92F(iii) of the IT Act, 1961 is reproduced hereunder:

"(iii) "enterprise" means a person ***(including a permanent establishment of such person)*** *who is, or has been, or is proposed to be, engaged in any activity, …. whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places;"*

Accordingly, the Indian tax laws require transfer pricing regulations to be applied for attribution of profits to PE by treating it as an independent and separate enterprise. In other words, the Indian tax laws require that for computing profits attributable to PEs of non-residents, it is necessary to apply the TPR.

The Indian tax laws do not contain any detailed guidelines or regulations on the issue of profit attribution to PEs. However, under the TPR the provisions of Chapter X of the IT Act, 1961 may apply to PEs, and consequently determination of ALP of transactions with its AE. Various judicial precedents including the landmark decision of Hon'ble Supreme Court in the case of Morgan Stanley and Co.[35] have discussed and addressed the ongoing controversial issue of profits attributable to PEs in India and stated that profits attributable to a PE shall have to be determined based on FAR analysis, i.e. functions performed, assets employed and risks assumed, based on arm's length principles.

Conclusion

Transfer pricing audits in India have generated great controversies because of an exponential increase in audit activity and the resulting transfer pricing adjustments. The revenue authorities seem to be focused on generating huge revenues from adjustments, because of non-adherence to the arm's length standard by associated entities in their cross-border dealings.

The transfer pricing audit controversies have emerged in respect of various transactions, for example, re-characterisation of heavy marketing spend, reimbursement of marketing cost, intra-group services, transfer / use of intangibles, etc. These issues can find their echo internationally, as governments throughout the globe grapple with the same. These issues need to be understood in the background of various controversies generated by the evolution of ingenious business models, whereby MNE's shield profits from tax. This may be viewed by the countries where the profits arise or are sourced, as having unfairly shifted profits to low tax jurisdictions.

This has led to the OECD coming out with various action plans under the Base Erosion and Profit Shifting programme to address such shifting of profits, with a view to enable countries to secure their tax base.

The new reporting norms of global business structures and information regarding profitability of the various group companies namely Country-by-Country reporting, etc. will probably usher in more transparency in the business dealings of MNEs.

In this background taxpayers will need to evolve methodologies to capture business data, with a view to demonstrate their *bona fide* and economic substance of transactions. This will help them in correctly depicting the arm's length nature of their controlled transactions.

35 Morgan Stanley & Co. vs. DIT [292 ITR 416]

CA T. P. Ostwal

The Future of Transfer Pricing

1.1 International tax issues have never been higher on the political agenda as they are today. The integration of national economies and markets has increased substantially in recent years, putting a strain on the century old international tax rules. Weaknesses in these rules created opportunities for base erosion and profit shifting which required bold moves by policy makers to restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created. Over several decades and in step with globalisation of the economy, world-wide intra-group trade has grown exponentially. The significance of the transfer pricing rules used by tax administrations has increased in light of the growing intra-group international trade. As the OECD's BEPS Action Plan identified in 2013, the existing international standards for transfer pricing rules can and are being misapplied so that they result in outcomes where the allocation of profits, and thereby payment of taxes, is not aligned with the economic activity that produced such profits. BEPS Action Plans have created opportunities and challenges. As tax professionals involved in transfer pricing work, it is pertinent for us to note that the current provisions of Chapter VI of the OECD Transfer Pricing Guidelines have been deleted in their entirety and replaced by new provisions. Therefore, we need to first un-learn what we know and re-learn what is new.

1.2 The principle of arm's length price ("ALP"), which is the cornerstone of transfer pricing regulations globally – requires associated enterprises to transact at a price as if they were independent, at a price that would be charged in comparable transactions in similar conditions between third parties. However, due to the current manner in which ALP is determined i.e. with more emphasis on contractual allocation of risks, functions, and assets, the principle has been proven to be vulnerable to manipulation. The measures suggested in the Action Plans seek to clarify and strengthen the principle and introduce special measures either within or beyond ALP principle in order to correct transfer pricing risk. Specific guidelines have been provided to aide in selection of the most appropriate method of ALP determination in a wide range of scenarios involving intangibles – especially when intangibles are used in combination, or are used to provide services or in the sale of goods and also where the intangibles are hard to value.

1.3 Action Plans 8, 9 and 10 specifically deal with important aspects of economic activity and give guidelines and measures to target areas that would ensure that transfer pricing outcomes are aligned with value creation – these areas include intangibles, risk & capital, low value-adding intra-group services.

1.4 In today's scenario, intangibles affect nearly every aspect of economic activity in the twenty first century. Intangibles have become a major source of sustainable competitive advantage for many firms. The importance of intangibles in the economy has been growing for decades in a number of sectors. The information and communication technology (ICT) revolution has made some technologies cheaper and more powerful, enabling improvement of business processes and boosting innovation across virtually all sectors of the economy. This technological evolution has made intangibles increasingly important profit drivers in many individual businesses. It is, therefore necessary, to give careful consideration to intangibles when conducting a transfer pricing analysis.

1.5 Transfer pricing issues can arise when MNEs develop, acquire, exploit or transfer intangibles. Various entities within an MNE group may participate in intangibles development functions like research, development and marketing, providing funding for acquisition and development of intangibles, and in exploiting intangibles in a wide range of business activities. These activities should be rewarded on an arm's length basis. The business operations of one member of the MNE group may require the use of intangibles developed or owned by other group members. Use by one member of the MNE group of intangibles belonging to or developed by other group members should be compensated on an arm's length basis.

1.6 Intangibles are often unique which makes them extremely difficult to accurately value; they may be vital to the successful operation of the MNE group's business. Transfer pricing issues related to intangibles can be very challenging for both tax administrations and taxpayers in both developed and developing countries. In carrying out a transfer pricing analysis involving intangibles, it is necessary to consider: (i) the identification of the specific intangibles involved, (ii) the ownership of intangibles within the MNE group, (iii) the value of the identified intangibles, (iv) how the intangibles contribute to the creation of value by the MNE group, and (v) the identity of the members of the MNE group that contribute to intangible value and how they should be rewarded. Transactions that involve intangibles could be of two broad types – (i) they involve the actual transfer of the intangible or the right to use the intangible; (ii) they involve the use of the intangible in the provision of service or sale of goods. The transfer pricing regulations are now placing greater attention on dealing with intangibles so that analysis is not weakened due to information asymmetries between the tax-payer and the tax-administration with respect to transactions involving intangibles, especially those that are hard to value.

1.7 The other important aspect to be considered is the contractual allocation of risks, and the ultimate allocation of profits to those risks – often this does not correspond with the activities actually carried out. Recent cases involving Apple in the Ireland and Indonesia and investigations against French energy major Engie SA in Luxembourg highlights the shifting emphasis tax administrations and governments are placing on ensuring that profits are not shifted to lower tax jurisdictions by mere contractual arrangements. Often capital-rich MNE group members, especially those that are intentionally located in lower tax countries, provide capital to group entities in other jurisdictions and although the entire risk is borne by the capital receiving entity, majority of the profits are shifted to the capital providing entity as returns – in such cases the level of returns do not correspond to the level of activity or risk undertaken by the funding entity.

1.8 The letter of the law, which current places more significance on the form of a transaction over its substance has allowed MNEs to structure their business and transactions in a manner that makes it appear that the major risk and economic activity is located in lower tax jurisdictions and therefore shift a substantial portion of profits to these locations while in actuality the risk-bearing and value generating activity takes place elsewhere. The new guidelines seek to look beyond the form of a structure or transaction and determine where the actual risk is borne and value is generated so as to ensure that the returns that are reported match the amount of risk borne and value generated.

1.9 The other area where transfer pricing laws are changing is with respect to high risk areas such as profit allocations the result from transactions which are not necessarily commercially rational for the individual enterprise by introducing re-characterisation if necessary, the use of transfer pricing methods to divert profits from economically important but low cost activities of the MNE group and neutralising the use of certain types of payments between MNE group members such as management fees and head office expenses that merely erode the tax base and are not aligned with value creation.

1.10 The rules seek to prevent tax avoidance by preventing transactions that would not or would only rarely occur between independent third parties by clarifying situations where transactions need to be re-characterised.

1.11 The BEPS report has guidelines which respond to such issues and work to ensure that transfer pricing rules secure outcomes that see operational profits allocated to the economic activity that generate them and prevent the use of complex structures involving intangibles or contractually allocated risks or commercially irrational arrangements from defeating the intent and purpose of such rules. The report and its guidelines have been formally accepted and subscribed to by all OECD and G20 countries, representing a commitment from countries that make up the major share of the global GDP to amend their domestic laws and co-operate with other countries in order to deal with transfer pricing issues based on common approach.

1.12 However, this would not be an easy task. The achievement of the herculean objectives of the BEPS Actions requires the careful delineation of the transactions between associated enterprises, the analysis of contractual relations between parties in combination with the conduct of the parties. The conduct would replace of supplement the contractual arrangements where the contracts are incomplete or not supported by conduct. Appropriate application of pricing methods that prevents misallocation of profits to locations which do not contributed to those profits would also have to be done.

1.13 The guidelines have made it clear that no profit seeking business would take on risk without expecting a positive return – the economic notion that higher risks warrant higher anticipated returns made MNE groups deploy tax strategies based on contractual re-allocation of risks, often without a change in the underlying operations. Going forward, contractually assumed risks by parties that cannot exercise meaningful control over the risks or do not have the financial wherewithal to assume that level of risk would be re-allocated to parties that actually do exercise the control and do have the financial capacity to assume the risk.

1.14 In today's scenario, legal ownership of an intangible bestowed the right to all or any returns generated by the exploitation of the intangible. Group entities performing important functions such as controlling and assuming economically significant risk and contributing assets to such intangibles would be entitled to appropriate returns that reflect the value of their contributions determined through accurate delineation of the transaction.

1.15 The situation where a capital rich entity provides funding (called 'cash-boxes'), but does not perform any activity or control the financial risk associated with the funding would not be allocated more than a risk-free return from the profits associated with such funding. Only where the funding member of the MNE actually assesses the creditworthiness of the entity receiving the funds and where the transaction is commercially rational would a more than risk-free return be justified and acceptable.

1.16 The BEPS Action Plans concerning transfer pricing risks are also linked holistically to other Actions. The interest deductibility rules under Action Plan 4 would cover the already marginal profits earned by cash-boxes where the return qualifies as interest or an economically equivalent payment. Further, Action Plan 6 would make it difficult to avoid withholding taxes by structuring payments to a cash-box which is the tax-resident of a certain country if the same amounts to treaty-abuse. Finally, a cash-box which has limited economic activity would be a target of Controlled Foreign Corporation rules under Action Plan 3 and the documentation requirements under Action Plan 13 such as the Country-by-Country Report, would ensure that all pertinent information is available with the tax-administrations of all those countries where the cash-box and its associated enterprises are situation so as to identify and deal with profit shifting strategies. The transparency requirements prescribed by Action Plan 13 would ensure better transfer pricing analysis based on global and local information on operations, MNE group revenues, profits, taxes and economic activity. In addition to improving access to relevant information, Action Plan 13 also contains guidance on transaction involving commodities and low value adding intra-group services. Transfer pricing depends on study of the specific facts and circumstances and often involves subjective interpretation of these facts and circumstances – dispute resolution due between taxpayers and tax-administrations due to difference in interpretation would be made easier due to the introduction of a minimum standard, as suggested by Action Plan 14, that would provide access to Mutual Agreement Procedures.

1.17 These revisions to the Guidelines will provide better direction to transfer pricing analysis – both to tax-payers and administrators. More emphasis has been placed on accurate delineation of transactions and relationships between associated enterprises – including supplementation, where necessary, to the terms of the contract with evidence of actual of the parties and determining the actual contribution of each group member to whom profit is or isn't allocated in line with the risk assumed and control exercised and value created. The revisions have reinforced the need for tax-administrations to be able to disregard transactions between associated enterprises when exceptional circumstances of commercial irrationality apply. It has also recognised that allocating risks on paper does not in itself shift profits.

1.18 Another important change is the direction to adopt a broad and clear definition of intangibles and developing transfer pricing rules or special measures for transactions involving hard-to-measure intangibles thereby ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with value creation. While applying the ALP principle, tax administrations would be reviewing the difference between the anticipated returns and the actual returns from transactions involving intangibles. The assessment of which member of an MNE group controls the performance of functions in relation to the development, acquisition, enhancement, maintenance, protection and exploitation ("DAEMPE functions") of the intangible will enable the determination of the accurate risk assumed by the member and the appropriate allocation of profits from the intangible.

1.19 Additionally, the valuation of intangibles and the contribution from the intangible in a transaction would form an integral part of ALP determination. Tax administrations would find it difficult to value intangibles due to information asymmetries – especially since MNEs would closely guard any information about intangibles. While valuing hard-to-value intangibles or transaction where individual or separate intangibles are used in combination, tax-payers would have to demonstrate that the pricing is based on a thorough analysis. Tax administrators would be able to consider ex post outcomes (i.e. pricing based on actual outcomes) as presumptive evidence of the appropriateness of ex ante pricing (i.e. pricing based on forecasts) if the tax-payer cannot demonstrate that the difference is largely due to unforeseeable circumstances.

1.20 The transfer pricing guidelines have also provided guidelines on the use of valuation techniques in the determination of ALP. Manipulating the value of an intangible would be difficult in the confines of objective guidelines and rules governing the selection of the method of valuation and the use of metrics and assumptions in the valuation process.

1.21 While intangibles account for a significant portion of transfer pricing risk, low value adding intra-group services are often used by MNEs to shift a large portion of profits to conveniently located profit accumulation centres. A balance must be achieved between the need to allocate appropriate charges for intra-group services in accordance with ALP principle and the need to protect the tax base of payer countries. In light of this, specific guidelines have been provided on a wide category of intra-group services which command very limited profit mark-up on costs, consistent allocation of charges for all recipients of intra-group services and greater transparency through more reporting including documentation to show the determination of the specific cost of the service. All the associated enterprises operating within similar circumstances must be treated equally while costs are being allocated – no overpricing or inflation of intra-group service costs would be possible when the category of costs that can be considered in the cost base and the mark-up that can be charged is prescribed.

1.22 The guiding principle is that businesses should be only willing to incur those costs which have a business reason rather than to shift profits – the BEPS Action Plan has proposed a simplified, elective approach instead of the detailed testing of benefits received that is currently the method in ALP determination for intra-group service charges. However, countries would still retain the right to conduct an in-depth transfer pricing analysis of the service charges if they exceed certain defined thresholds – therefore in cases where MNEs adhere to the prescribed guidelines but still manage to overcharge for intra-group services, the shifting of profits would be limited since the service charges would attract scrutiny if they exceed the defined threshold.

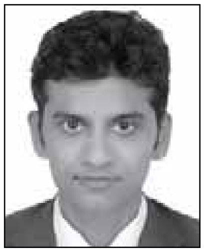
1.23 The increasing guidelines and rules in areas like intangibles, business risk and value creation are often seen by businesses and tax-payers as inconvenient distractions that restrict the ability to increase the overall profitability and trim the tax bill. Having objective criteria in connection with highly subjective and complicated areas such as intangibles and value creation while allowing for subjectivity in interpretation of clear contractual arrangements and allocations would lead to disputes between tax-payers and tax-administration. While tax-payers are naturally inclined to take the view that increasing guidelines and rules make doing business difficult, tax administrators welcome the clarity they provide.

1.24 As such, transfer pricing laws and tax administrations have caught up with the practices and strategies of large MNE groups that have till now taken advantages of the seemingly primitive and unsophisticated principles that guided tax-administrations and tax laws – the greater degree of co-operation between different countries, especially developed and developing countries, and the willingness to share information and co-develop regulations that are consistent, if not uniform across the globe would make artificially shifting profits and paying low, and in some case no, taxes, much harder than before. The global community, which now consists of a much larger and better informed working middle-class, are frowning upon once ignored tax 'strategies' of large MNEs. There is better understanding and more information regarding what companies are doing, much in thanks to dissemination of information through the internet, increasing anti-capitalist activism, and a greater media scrutiny and incidents like the 'Panama' leaks and 'Bahamas' leaks – this has lead to the expectation amongst not only shareholders but other stakeholders also that companies pay their fair share of taxes and behave like responsible corporate citizens of the world.

1.25 Tax-payers need to recognise and accept that shifting profits will become increasingly difficult, while tax administrations must appreciate that prohibitive laws would have a negative long-term impact on the tax base that would be equal to, if not greater than that of profit shifting practices of MNEs.

1.26 India, having committed to the adoption of BEPS Action Plans has already introduced several suggested measures in the domestic law. Being a developing economy, adopting measures to curb profit shifting and protecting the tax base is an important aim of the tax-administration. Now that transfer pricing laws are changing and the guidelines are being regularly revised and updated, this sphere of international taxation has become more dynamic and challenging than ever.

1.27 Given the current thrust on aligning transfer pricing outcomes with value creation, the building momentum of the Indian economy, and the increasing investment flowing into and from India, the future of transfer pricing is exciting.

CA Vaishali Mane, CA Gaurav Jain
Priya Bhutani, MBA & Abhay Rastogi, MBA

"Associated Enterprise" and "International transaction" – deciphering the evolving law of transfer pricing

I. Introduction

Chapter X of the Income-tax Act, 1961 ('the Act') lays down special provisions in relation to avoidance of tax. As part of this chapter, rudiments of transfer pricing ('TP') are elucidated in section 92 to section 92F of the Act. Recently, conflicting viewpoints of the taxpayer and tax authorities has been witnessed on the fundamental applicability of sections 92A and 92B of Act.

This chapter aims to analyse the law in the light of recent judgments and also deliberates on the amendments made in Section 92B *vide* Finance Act 2012 and Finance Act, 2014.

II. Associated Enterprise ('AE')

Identification of the AE sets the tone for undertaking a TP analysis. Any transaction is required to have regard to the arm's length principle if undertaken between two AEs.

Definition

The section 92A of the Act defines AE as below:

92A. (1) For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", in relation to another enterprise, means an enterprise—

(a) Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(b) In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

(2) For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,—

(a) ……..

…………….as may be prescribed.

Understanding

Simple reading of section 92A(1) gives an understanding that two enterprises become AEs, if one enterprise participates in the management, capital or control of other enterprise either directly, indirectly or through one or more intermediaries.

As one advances to read sub-section (2) of section 92A the understanding gathered could be that for the purposes of section 92A(1) two enterprises are deemed to be AEs if they satisfy one of the clauses (a) to (m) mentioned in this section.

The definition of section 92A(2) was explained *vide* Memorandum of Finance Bill 2002 as below:

""It is proposed to amend sub-section(2) of the said section to clarify that the mere fact of participation of one enterprise in the management or control or capital of the other enterprise or the participation of one or more persons in the management or control or capital of both the enterprises shall not make them associated enterprise unless the criteria specified in sub-section (2) are fulfilled."

The point of deliberation is that – *whether for constituting relationship as AEs section 92A(1) and 92A(2)of the Act are to be read separately or a unified reading of the same is required?* In other words, the following questions are vital to be contemplated:

- If two entities satisfy the provisions of section 92A(1) of the Act can they be termed as AEs irrespective of the fact that they do not meet either of the clauses mentioned in the following sub-section (2)?
- If two entities that meet any of the clauses (a) to (m) mentioned in section 92A(2) of the Act can be determined to be AEs irrespective of the fact that neither of the entities have any participation in other enterprise's management, control or capital?

Judgments

The above issues can be examined in light of following recent judgments.

1. Page Industries Ltd.[1]

Background: The taxpayer was engaged in the manufacturing and sale of ready-made garments. The taxpayer licensed the brand name 'Jockey' for exclusive manufacturing and marketing of Jockey readymade garments to Jockey International Inc. USA ('JII').

Assessment proceedings: The transfer pricing officer ("TPO") made an adjustment of approx. INR 20 crores using bright line method on the advertisement spend incurred by the taxpayer.

Aggrieved the taxpayer filed its objections before the Dispute Resolution Panel ('DRP').

DRP proceedings: The taxpayer contended that the transaction of the taxpayer with JII is not an international transaction since it is not undertaken between AEs. The taxpayer argued that since the conditions specified under section 92A(1) of the Act are not existing between it and JII they were not AEs as per law.

On the other hand, the tax authorities contended that the taxpayer and JII met clause (g) of section 92A(2) of the Act and therefore the transactions between them needs to comply with the arm's length principle. Consequently, the DRP upheld the TPO order.

ITAT observation: The Bangalore Income-tax Appellate Tribunal ('ITAT') decided this matter as follows:

- The taxpayer was merely a licensee of the brand name and owned the entire manufacturing facility, capital and employees by itself. Further, there was no participation of JII in taxpayer's management, capital or control of the taxpayer. Considering the memorandum mentioned above, ITAT emphasised that on the face, it appears that requirements of both sub-section (1) and (2) have to be met for constitution of AEs.
- Where two provisions of a statute exist then while interpreting law preference should be given to the one whose principle stands effective without making the other provision redundant. Drawing inference to this case if one were to conclude that the taxpayer and JII were indeed associated under section 92A(2) then provision of section 92A(1) would become superfluous.

1 Page Industries Ltd. vs DCIT [IT(TP)A No. 163/Bang/2015]

ITAT ruling: It was held that since the taxpayer and JII do not meet the parameters laid down in section 92(A)(1) they cannot be constituted as AEs and accordingly provisions of Chapter X do not get invoked.

2. Kaybee Private Limited[2]

Contrarily, in this case the Mumbai ITAT decided the case in the favour of the tax authorities.

Background: The taxpayer was engaged in running business centres by providing business amenities. In course of its business it received service charges towards certain purchases made on behalf of Kaybee Exim Pte Limited, Singapore ('Kaybee Singapore').

Assessment proceedings: The TPO contended that since taxpayer and Kaybee Singapore had a common person as director in tax payer and Chief Operating Officer ('COO') in Kaybee Singapore the two entities have common control and are thereby AEs by virtue of provision of section 92A(1).

The taxpayer contended that since none of the clauses as mentioned in section 92A(2) of the Act are met, they cannot be termed as AEs. In addition, the taxpayer relied on the explanation provided in memorandum to Finance Act, 2002.

ITAT observations/ruling

- The ITAT held that even if the conditions provided in clause (a) or (b) of section 92A(1) of the Act are independently satisfied then the two enterprises would be considered as AEs. In the present case since a common person had control by way of decision making in both entities they will be treated as AEs under section 92A(1).

3. Diageo India Private Limited[3]

ITAT observations/ ruling: Mumbai Tribunal held that whether two entities are AEs needs to be tested under section 92A(1) of the Act. Clauses of deeming fictions set out in section 92A(2) are only illustration of the manner in which 92A(1) has to be applied.

Corollary

Section 92A(1) lays emphasis on 'management', 'control' and 'capital' for triggering the AE relationship. As these terms are subjective in nature it was generally construed that the clauses of section 92A(2) clarify them. This understanding was strengthened by the amendment made to sub-section (2) and the opening words *"For the purposes of Sub – Section (1)"*.

However, this view has been negated by the decisions in case of Kaybee and Diageo and hence one needs to take appropriate safeguards in this context. Also, one cannot ignore that the facts related to each case is unique and subjective and there can be instances when courts' decisions may not squarely apply. Therefore, in addition to ensuring that the intent of the law is not forsaken a correlated analysis is to be undertaken after taking into consideration the individual facts and the provisions of law.

III. Amendment to section 92B by Finance Act, 2012 – prospective or retrospective?

Section 92B of the Act defines the term "international transaction" as a transaction between two or more AEs, either or both of which are non-residents, in the nature of purchase, sale or lease of intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profit, incomes, losses or assets of such enterprise.

2 Kaybee Private Limited vs. Income tax Officer (ITA No. 3749/Mum/2014)

3 Diageo India Private Limited vs. DCIT (ITA No. 8602/Mum/2010)

An explanation was inserted in section 92B by Finance Act 2012 to clarify the expression "international transaction" and "intangible property" with retrospective effect. Pursuant to this retrospective amendment, certain transactions like outstanding receivables, issuance of corporate guarantee etc. were brought under the ambit of TP regulations leading to substantial adjustment in the hands of taxpayer specifically at the assessment level.

Understanding

Generally, retrospective law that broadens the tax base is undesirable because it is contrary to the principles of natural justice and may be oppressive.

The Apex Court in its landmark judgment in the case of **Krishnamurthi & Co. Etc.**[4] held that though the legislature can make a law with retrospective provisions, the Courts could on an appropriate challenge expunge it on the ground of contravening fundamental rights.

Legislation can be categorised as:

i. Substantive law and

ii. Procedural law

Substantive law is a law which creates rights, obligations and duties; while procedural law determines how a proceeding concerning the enforcement of substantive law will occur. On substantive law, the general proposition is that amendments take effect prospectively, however, amendments made to procedural law, could be either retrospective or prospective depending on the facts of the case.

Amendment to section 92B of the Act is viewed as an amendment to substantive law since it results in enhancement of the scope of international transactions as envisaged under erstwhile section 92B of the Act. Accordingly, a normal presumption amongst the TP practitioners at large is against the retrospective applicability of such amendment. The premise behind such presumption is that the legislation introduced for the first time need not change the character of past transactions carried out upon the faith of the then existing law.

Judgments

1. Siro Clinpharm Private Limited[5] and Rusabh Diamonds[6]

ITAT ruling: It was held that explanation to section 92B of the Act inserted vide Finance Act, 2012 can only have prospective applicability effective from 1st April, 2012.

ITAT observations:

- TP provisions are inherently an anti-abuse legislation which only seeks to inculcate a degree of compliant conduct in the taxpayers and should not be construed as a source of income. Accordingly, any amendment in the said provisions can only be prospective as taxpayer cannot be told today as to how he should have behaved in the past.

- The subject amendment though stated to be clarificatory does increase the scope of international transactions under section 92B of the Act and hence should be treated as effective from assessment year ('AY') 2013-14 onwards only. The Tribunal relied on the high court ('HC') ruling of **New Skies Satellite BV**[7] wherein it was held that amendments though originally notified as clarificatory may turn out to be substantive in fact and such a substantive amendment is incapable of being given retrospective effect.

4 Krishnamurthi & Co. etc. vs. State of Madras & Anr. (1972 AIR 2455)

5 Siro Clinpharm Private Limited vs DCIT (ITA No. 2618/Mum/2014) & DCIT vs Siro Clinpharm Private Limited (ITA No. 2876/Mum/2014)

6 Rusabh Diamonds vs ACIT (ITA No. 2840/Mum/2014) & ACIT vs Rusabh Diamonds (ITA No. 2497/Mum/2014)

7 DIT vs New Skies Satellite BV (ITA 473/2012) & DIT vs New Skies Satellite BV (ITA 474/2012)

- It was also observed that the Tribunal can defy the specific words of the provisions of the statue and tinker with the date set out there in provided there is a binding judicial precedent which requires such action on their part. Conversely, if it is presumed that the insertion of explanation to Section 92B did not enlarge the scope of international transaction, there is no rationale to depart from the decision of the coordinate benches prior to such amendment on the subject issue.

Corollary

Taking cognizance of the above rulings and other related factors it is imperative that due consideration should be given to intent of the legislature, the memorandum to the relevant Finance Act, and hardship caused to the taxpayer in determining whether a provision is applicable prospectively or retrospectively. Though Parliament has authority to pass a retrospective law but such a retrospective amendment should not impair an existing right or obligation except where such an amendment is a procedural one.

IV. Deemed International transaction – Pre and Post Amendment in Finance Act, 2014

Understanding

Section 92B(1) of the Act defines the term 'international transaction' as the transaction between two or more AEs either or both of whom are non-residents. The said definition makes it crystal clear that at least one of the transacting entities must be non-resident in India for the transaction to qualify as an 'international transaction'.

Section 92B(2) of the Act creates a deeming fiction which extends the ambit of the term international transaction to include those transactions which an entity enters into with other entities which are not its AEs (hereinafter referred to as 'third party') provided either of the two conditions mentioned below are fulfilled:

- There exists a prior agreement in relation to the subject transaction between the third party and the AE of the entity

  or

- Terms of the relevant transaction are determined in substance between AE of India taxpayer and such third party

The rationale behind this clause was to prevent the taxpayers from escaping the rigours of TP provisions in situations where the transaction appears to be between independent parties when viewed in isolation, however, in substance is influenced by the AE.

Unlike section 92B(1) of the Act which clearly states that at least one of the transacting entities should be non-resident, there was an ambiguity and uncertainty on the applicability of the of section 92B(2) when both the transacting entities were resident in India.

The tax authorities have been invoking the deeming provisions in cases where transactions are entered into by Indian taxpayer with Indian third parties. On the other hand, the taxpayers contended that clause (2) of section 92B cannot be read in isolation of clause (1) of section 92B of the Act and deeming provision cannot be invoked unless either of the transacting parties is non- resident in India. There are judgments both in favour and against the treatment of such delineated transactions as 'international transaction'.

Judgments

In the following rulings it was held that a transaction between two resident entities cannot be brought under the ambit of the term international transaction by invoking the deeming fiction of section 92B(2) of the Act.

1. Astrix Laboratories Limited[8],
2. IJM (India) Infrastructure Limited[9]
3. Swarandhara IJMII Integrated Township Development Co. Pvt. Ltd.[10]

On the other hand, in the following rulings it was upheld that the transaction between two resident entities can be deemed as an international transaction under section 92B(2) of the Act on account of concerted agreement between the taxpayer, its AE and the 'third party':

1. Novo Nordisk India Private Limited[11]
2. G4S Security Services (India) Pvt Ltd.[12]

Finance Act 2014 brought out an amendment in sub clause (2) of section 92B with effect from 1 April 2015 to clarify that the residential status of the 'third party' is not relevant to invoke the deeming fiction under clause (2) of section 92B of the Act. Thus, a transaction which an entity enters into with an unrelated resident person would be deemed as an international transaction provided it fulfils the two conditions highlighted above.

Corollary

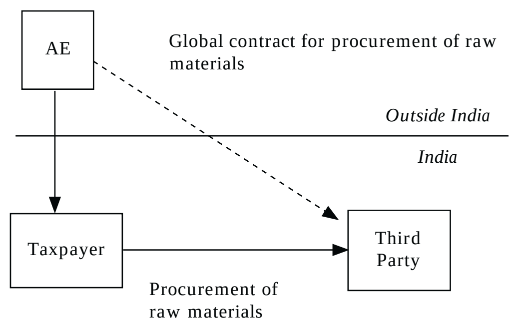
The amendment is expected to have a far reaching impact on the multinational groups. This is because it is a usual practice for multinational groups to enter into global supply agreements for all its group entities across the globe. The essence of such agreements is to get better prices, volume discounts and standardised quality products and services for all its group companies by identifying vendors through a centralised agreement. The vendors supply goods and services to all the group entities of the multinational group through their local counterparts. The price which those local counterparts demand from the group entities may or may not be decided on the basis of the global supply agreement.

While this amendment should reduce the ambiguity on this issue, at the same time it may be onerous for MNCs to monitor and analyse such arrangements carefully from TP perspective.

V. Triangular and Quadrangular arrangements

In triangular or tri-party agreements, the transaction between the taxpayer company and the other entity is governed by way of a tri-party agreement between the taxpayer company ('A'), its AE ('B') and the 'other entity' ('C'). Thus, it can be reasonably assumed that the terms of the transaction between A and C are in effect determined by B. A diagrammatic representation of triangular arrangement is shown below:

Triangular

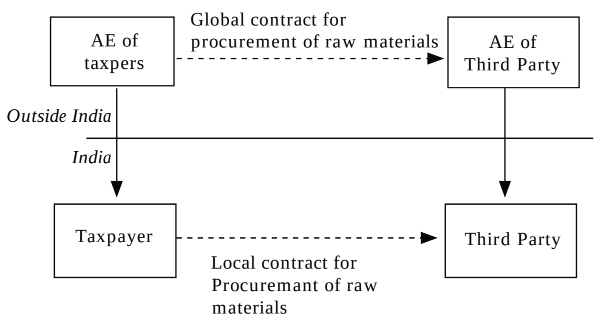


On the other hand in a quadrangular agreement, the AE ('A') of the taxpayer ('B') enters into an agreement with an independent third party ('C') (hereinafter referred to as 'first agreement'). In pursuance of the first agreement, B enters

8 Astrix Laboratories Limited vs ACIT (ITA No. 2181/Hyd/2011)
9 DCIT vs IJM (India) Infrastructure Limited (ITA No. 43/Hyd/2014)
10 Swarandhara IJMII Integrated Township Development Co. Pvt. Ltd vs DCIT (ITA No. 53/Hyd/2014)
11 Novo Nordisk India Private Limited vs DCIT (ITA TP No. 122/Bang/2014)
12 DCIT vs G4S Security Services (India) Pvt Ltd (ITA No. 321,3979 and 5351/Del/2009)

into an agreement with a local counterpart of C in India ('D') (hereinafter referred to as 'second agreement'). Thus, the transaction between B and D, both of whom are resident in India and are not AEs are governed by two separate agreements. If B & D do not enter into second agreement for the said transaction or terms of the agreement between B & D are in substance determined by first agreement, then the transaction between B & D would be deemed as an international transaction. A diagrammatic representation of Quadrangular arrangement is shown below:

Quadrangular Arrangement



However, if B & D enter into an independent agreement to determine the terms of the transaction between them, the transaction would fall outside the provision of section 92B(2) of the Act.

Judgments

1. Kodak India Private Limited[13]

ITAT Ruling/observation

- Mumbai ITAT gave a categorical finding that the terms of transaction between Kodak India, the taxpayer, and independent third party in India with whom Kodak India had entered into transaction with was not governed by the agreement which the parent entity of Kodak India had entered into with AE of the third party.
- The Hon'ble Bombay HC also rejected the appeal of the tax authorities against the above order on the premise that the tax authorities had not controverted the factual finding of Mumbai ITAT that the terms of the transaction between Kodak India and the independent third party have not been determined in substance by the AE of Kodak India.

2. Thomson Reuters India Private Limited[14]

ITAT Ruling/observation

- On similar facts, the Mumbai ITAT set aside the case to the file of the TPO to analyse the terms of the agreement between the Thompson Reuters, the taxpayer, and the Indian entity transacting with the taxpayer to see whether the terms of the agreement are in effect governed by the global agreement entered into by the AE of the taxpayer.

VI. Capital Financing

As discussed above, Finance Act 2012 retrospectively expanded the definition of international transactions defined under section 92B to include transactions in the nature of capital financing.

In the paragraphs below the authors have presented a review of various aspects of transfer pricing approach and related litigation on the issue of capital financing in the relation to issue of shares.

Definition

International transactions defined under Section 92B has been amended vide Finance Act 2012 by way of explanation to include:

13 CIT vs. Kodak India Private Limited (ITA No. 15/2014)

14 Thomson Reuters India Private Limited vs. ACIT (ITA No. 901/Mum/2014)

(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;

The charging section 92(1) states that:

92. *(1) Any income4 arising from an international transaction shall be computed having regard to the arm's length price.*

Understanding

While assessing a taxpayer's case in the past the tax officers increasingly scrutinised arm's length determination of the following aspect of a financial transaction:

Particulars	Revenue Department's approach
- Issue of shares issued by the Indian taxpayer to its shareholder	- Regarding shares issued to be under-priced, treat the difference in pricing as extension of loan and impute notional interest

However, the mist around applicability of transfer pricing provisions on the same has been cleared by the Hon'ble Bombay High Court in the case of Vodafone India Services Pvt. Ltd.[15] (Petitioner – taxpayer).

On the other hand, in a case where transaction undertaken is in the nature of transfer of shares the applicability of transfer pricing provisions on the same may be deliberated.

Judgements

As mentioned above, the Bombay High Court in its judgment after taking into consideration the legal provisions of section 92(1) of the Act, upheld that income [as defined under section (2)] arising from an International Transaction is a condition precedent for application of Chapter X of the Act.

It further held that neither the capital receipts received by the Petitioner on issue of equity shares to its holding company nor the difference in the fair market price of its equity shares and the issue price of the equity shares can be considered as income within the meaning of the expression as defined under the Act.

Tax can be charged only on income and in the absence of any income arising, the issue of applying the measure of arm's length principle ('ALP') to transactional value itself does not arise. Chapter X of the Act ensures that the transaction is charged to tax only after the same has been computed having regard to the ALP.

It also held that section 92(2) of the Act is not applicable in this case where there is no occasion to allocate any cost or expense between the petitioner and the holding company for any benefit, service or facility.

Relying on the above judgment, various benches of ITAT has relied and ruled on similar lines and held that issue of shares in the nature of capital transactions are beyond the scope of transfer pricing provisions:

- *Solvay Specialities India Pvt. Ltd. vs. DCIT (ITA No. 1702/M/2015 & ITA No. 630/M/2015)*
- *Supergems (India) Pvt. Ltd. vs, ACIT (ITA. No. 789/M/2013)*
- *Topsgrup Electronic Systems Ltd. vs. ITO (ITA No. 2115/Mum/2015)*

We further discuss the case of Visteon Asia Holdings Inc.[16] wherein the taxpayer (a US company) has sold its share in Indian company (Visteon Powertrain Control Systems India Pvt. Ltd.) to its Mauritian subsidiary (Visteon International Holdings Mauritius Ltd.).

The Hon'ble Chennai bench of ITAT in this case distinguished the applicability of transfer pricing

15 Vodafone India Services Ltd. vs. Union of India, ACIT, DCIT, DRP II (Writ Petition No. 871 of 2014)

16 Visteon Asia Holdings Inc. vs. Deputy Commissioner of Income-tax (ITA No. 723/Mds/2016)

provisions and demarcated the contrasting nature of transaction related to issue of shares and sale of shares.

The ITAT in this case upheld the adjustment using Discounted Cash Flow ('DCF') method made by the lower authorities. In the present the applicability of transfer pricing provisions were not questioned since the transaction under consideration was sale of share which gives rise to capital gain. Therefore, the taxpayer is liable to pay the appropriate capital gain tax.

Corollary

In the light of the above decisions it has been settled that transfer pricing provisions may not be applied in the absence of any income arising from a particular transaction, though the same qualifies to be an international transaction (strictly as per the definition). However in case of sale of shares wherein a capital gain arises for the taxpayer, the same falls under the purview of Chapter X of the Act.

However, one needs to be cautious that transactions in the nature of issue/sale of shares have to be looked at from the economic and commercial aspects of the inter-company arrangement along with the related statute.

VII. Issuance of corporate guarantee – Covered or outside TP provisions?

Financial arrangements between the multinational corporations have witnessed increased scrutiny from the tax department in the recent past majorly due to the amendment in section 92B of the Act. One such financial transaction where there has been constant litigation owing to divergent views of the co-ordinate benches and lack of clarity in the Act is 'issuance of corporate guarantee'.

Judgments

The Hon'ble Delhi bench in the landmark case of **Bharti Airtel**[17] held that issuance of guarantee is not an 'international transaction' under section 92B of the Act (even after the retrospective amendment to the definition of 'international transaction' by Finance Act, 2012) since it does not have any bearing on profits, income, losses or assets of the enterprises.

Hence, based on the said decision, if the taxpayer has not charged any guarantee fees and has not incurred any cost for provision of guarantee, the said transaction will be outside the purview of term 'international transaction' as defined under section 92B of the Act. The Tribunal also held that the impact on income, profit, losses and assets must be on real basis. Thus, issuance of guarantee could not be termed as 'international transaction' merely on the hypothesis that an impact could occur if the contacting entity default in its obligation.

Contrary to the finding of the Delhi bench in the case of Bharti Airtel, there has been several rulings, like **Prolifics Corporation Limited**[18] and **Hindalco Industries Limited**[19] wherein the ITAT have continued to treat corporate guarantee as an international transaction despite the taxpayer's reliance on the Bharti Airtel ruling during the course of ITAT proceedings.

Determination of ALP of the guarantee transaction where such transaction has been held to be an international transaction is matter of another debate. While TPOs have often resorted to bank guarantee rates and external website quotes for determination of ALP of guarantee transactions, the Tribunal in plethora of cases such as **Asian Paints**[20], **Everest Kanto Cylinders**[21], etc. has ruled that reliance on third party bank quotes and website quotes are not

17 Bharti Airtel Limited vs ACIT [2014] 63 SOT 113 (Del.)

18 Prolifics Corporation Limited vs DCIT (ITAT No. 237/Hyd/2014)

19 Hindalco Industries Limited vs DCIT (ITA No. 4857/Mum/2012)

20 ACIT vs Asian paints Ltd (ITA No. 1937/Mum/2010)

21 Everest Kanto Cylinder Ltd. vs. DCIT (ITA No. 542/Mum/2012)

a desirable practice for determination ALP of corporate guarantee fees. The Mumbai Bench in the case of **Glenmark Pharmaceuticals Limited**[22] has categorically held that bank guarantee quotes cannot be used to determine the ALP of corporate guarantee transaction due to the conceptual difference between the nature of two guarantees. In plenty of cases, the ITATs have applied the "rule of thumb" (i.e. guarantee commission rate ranging from 0.25% to 0.55%) for arriving at the ALP of guarantee transactions without resorting to any benchmarking exercise.

VIII. Is corporate guarantee a shareholder activity?

The concept of 'shareholder activity' which provides conceptual justification for exclusion of corporate guarantee in certain cases from the scope of TP adjustments has been explained in OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ('OECD TP Guidelines').

The OECD TP Guidelines defines the term 'shareholder activity' as an activity which is performed by a member of an MNE group (usually the parent company or a regional holding company) solely because of its ownership interest in one or more other group members, i.e. in its capacity as shareholder. This type of activity would not be considered to be an intra-group service, and thus would not justify a charge to other group members.

Judgments

The concept of 'shareholder activity' was duly appreciated by the Ahmedabad Bench in the case of **Micro Ink Limited**[23] wherein the Bench held that issuance of corporate guarantee in the nature of 'shareholder activity' and not involving any cost to the holding company does not amount to a "provision for services" and accordingly the said transaction is to be excluded from scope of 'international transaction' under section 92B of the Act.

The Bench also held that even if issuance of corporate guarantee is accepted as 'provision of service', such service needs to be attuned with commercial reality as no independent enterprise would issue guarantee without underlying security. Such guarantee can only be motivated by shareholder or ownership consideration.

Corollary

The concept of corporate guarantee is still at a very nascent stage in India and a series of conflicting judgements on this issue have resulted in uncertainty and scepticism amongst the taxpayers. Therefore, it is imperative that the Government expeditiously comes up with some requisite clarity on this contentious issue. In the meanwhile, it is only wise for the taxpayer to seek support from various international guidelines before drafting their policies on the inter-company financial arrangement.

IX. Parting Note

The approach of the taxpayer as well as the tax authorities in dealing with the issues has been evolving over time.

The Indian transfer pricing fraternity has resorted to international guidelines and judicial precedents to address a specific issue in this domain. However, with the divergent judgments by courts on issues discussed above, the application of strait jacket formula has become obsolete.

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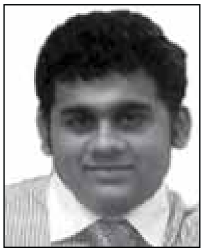
22 Glenmark Pharmaceuticals Limited vs. ACIT (ITA No. 5031/Mum/2012) & ACIT vs. Glenmark Pharmaceuticals Limited (ITA No. 5488/Mum/2012)

23 Micro Ink Limited vs. ACIT (ITA No. 2873/Ahd/2010)



CA Sagar Wagh[1]

Section 92 – Computation of Arm's Length Price – Part I

1. Introduction

An ultimate aim of any transfer pricing ('TP') benchmarking exercise is to arrive at arm's length price ('ALP'). As per section 92F of Income-tax Act, 1961 ('the Act'), the ALP is the price which is applied or proposed to be applied between enterprises other than associated enterprises (AEs) in uncontrolled conditions. While the aim of the TP provisions is to arrive at uncontrolled price, the computation of ALP does not simply entail selection of market price of a particular product or services, as available in public domain. This is because, the pricing of the product for a particular party is dependent on the stage of value chain in which such party is placed. For example: price charged by intermediary to final distributor for a particular product may not be comparable to the price charged by final distributor to end consumer.

Further, in many cases, due to nature of goods or services, the uncontrolled price may not be readily available in public domain. For example: price of active pharmaceutical ingredients (APIs) which is a key component to manufacture medicinal capsules may not be readily available in public domain.

Therefore, in order to provide scientific touch to the process of computation of ALP, the Act and Income Tax Rules, 1962 ('the Rules') have prescribed following methodology / steps:

- Analysis of the transaction under consideration
- Conducting function, asset and risk (FAR analysis)
- Selection of tested party and most appropriate method (MAM)
- Comparability and economic analysis

In this article, we will analyse some important facets of computation of ALP like selection and application of most appropriate method, aggregation v. segregation of transactions for benchmarking purposes, economic adjustments for ALP computation, concept of base erosion, *suo motu* adjustments and conditions when ALP can be determined by assessing offer ('AO') / transfer pricing officer ('TPO'). We will also examine relevant judicial precedents related to these concepts.

2. Factors to be considered for selection of most appropriate method

Section 92C of the Act provides for selection of the most appropriate method for benchmarking

1 Sagar Wagh is an international tax and transfer pricing specialist based in Mumbai, India. He is associate member of The Institute of Chartered Accountants of India. The views expressed in this article are personal.

the controlled transaction. While a particular transaction can be benchmarked using more than one method, the Act prescribes selection of a single method which may be most appropriate to the transaction under consideration. For example: in case where the gross profit margin earned from sale of manufactured goods to AEs can be readily computed and gross profit margin data of comparable companies is available in public domain which can be reliably compared with the tested party's gross profit margin then, cost plus method ('CPM') may be selected as most appropriate method. However, in this case, the transaction could have also been benchmarked using transaction net margin method ('TNMM') by comparing the net profit margin arising from controlled transaction with the net profit margin earned by comparable companies operating in industry.

Selection of particular method as most appropriate method for benchmarking the transaction under consideration depends on several factors like strengths and weaknesses of particular prescribed method, appropriateness of the method considered in view of the nature of controlled transaction, outcome of FAR analysis, availability of data in respect of comparable transactions, degree of comparability between controlled and uncontrolled transactions including the reliability of comparability adjustments that may be needed to eliminate material differences between them.

While the Act prescribes selection of most appropriate method without providing any hierarchy for such selection, the Indian tax tribunals / courts in the past have held certain class of methods to be more preferable over others. Such preference was given on account of erstwhile commentary of OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ('OECD TP Guidelines'). The OECD TP Guidelines has divided the methods into two classes viz. traditional transaction methods and transactional profit methods. The OECD TP Guidelines classify comparable uncontrolled price (CUP) method, resale price method (RPM) and CPM as traditional transaction methods, while the profit split method (PSM) and TNMM as transactional profit methods.

Prior to the 2010 version, the OECD TP Guidelines advocated the selection of traditional methods over the transactional profit methods, with a special preference for CUP. The reasoning given by guidelines was that, traditional methods are most direct means of establishing whether conditions in commercial and financial relations between AEs are at arm's length[2].

This is because, traditional methods take into account only comparable price or the factors for arriving at gross margin which are directly related / linked to particular comparable transaction for purpose of arriving at ALP, as compared to transactional profit methods which may be affected by several elements which may not be directly linked to comparable transaction / activity.

However, the 2010 version of OECD TP Guidelines in para 2.4 has acknowledged that, there are situations when transactional profit methods are found to be more suitable (vis-à-vis traditional transactional methods) such as, in a situation, where each of the party makes a unique contribution in relation to controlled transaction, or where the parties engage in highly integrated activities. Hence, the OECD TP Guidelines have done away with hierarchical approach in selecting the method for determination of arm's length price by abandoning its earlier position that, transactional profit methods may be used to approximate arm's length conditions when traditional transactional methods cannot be reliably applied alone, or exceptionally cannot be applied at all.

In the case of Serdia Pharmaceuticals (ITA Nos. 2469 / Mum. / 06, 3032 / Mum. / 07 and 2531 / Mum.08) the Mumbai bench of ITAT

2 Para 2.49 OECD TP Guidelines (1995 version)

post analysing the 2010 update to OECD TP Guidelines held that:

"even as there may not be any order of preference in which methods of determining the arm's length price must be considered, the traditional transaction methods, and particularly CUP, have an edge in the sense that all things being equal, CUP and traditional transaction methods are preferred over the transaction profit method."

This is because, para 2.2 of the OECD TP Guidelines 2010 still provides that traditional transaction methods are to preferred over transactional profit methods when both class of methods can be applied in equally reliable manner. Further, the guideline provide a special preference to CUP method among all the methods.

Let us analyse the relevant factors for selection of each of the method prescribed in section 92C of the Act.

CUP method

CUP method is selected in cases where price in respect of comparable uncontrolled transaction is readily available. The method involves testing the comparable uncontrolled price against the price charged / paid in controlled transaction. However, CUP cannot be selected as most appropriate method solely because data in respect of uncontrolled prices are available. It is extremely important that, the actual transactions which corresponds to such uncontrolled price data are comparable to the controlled transaction under consideration. This is because, the price of product / services is dependent on several factors like characteristics, quality, contractual terms etc. Even minor differences between two products / services may result in difference in their prices. Hence, application of CUP requires satisfaction of strict comparability requirements between the products to be compared. Therefore, CUP can be termed as most rigid method when it comes to selection of MAM.

RPM

RPM can be selected as MAM for benchmarking the transactions involving trading of goods / services. This is because, RPM aims to benchmark the gross margin earned from resale of goods (which were purchased from AEs) to an unrelated customer. RPM can only be applied in situations where the goods purchased by taxpayer from its AEs are resold without any further value addition or manufacturing. This is because, the aim of RPM is to arrive at ALP post deduction of arm's length gross margin and other purchase expenses from the resale price. Thus, RPM cannot be applied in cases where cost of the product or end price is enhanced on account of further value addition or manufacturing by taxpayer post purchase of goods from its AE. However, packing of end products for further distribution / sale may not be termed as value addition or further manufacturing.

CPM

CPM can be selected as most appropriate method in transactions involving sale of goods or provision of services to AEs. CPM can be applied readily in cases where gross profit arising from sale of goods or provision of services can be reliably ascertained.

PSM

PSM is applied in cases involving transfer of unique intangibles or in cases where multiple transactions which are so interrelated that, they cannot be evaluated separately. PSM is a two sided method, as it evaluates all the parties to the transaction, so as to ensure that, split of profits between / among the parties is at arm's length. It is a reliable method in cases where, transactions are so interlinked and contributions made by parties to the transactions are so unique that, testing profit of a single entity which is party to the transaction may not provide reliable results on arm's length nature of the transaction.

TNMM

TNMM involves comparison of net profit margin earned from a controlled transaction with the net profit margin earned from an uncontrolled transaction. TNMM is the most flexible of all the TP methods, as TNMM puts more emphasis on functional comparability rather than product or transaction comparability. Accordingly, two or more enterprises operating in same industry or taxpayer's internal uncontrolled transactions of comparable quantum can be compared for TNMM application where the level of functions performed, risks assumed and assets deployed are similar, irrespective of the fact as to whether the products sold / services provided by these enterprises / in internal uncontrolled transactions are exactly similar to taxpayer's controlled transaction.

However, it is important to note that, acceptance of broad comparability criteria does not mean that, enterprises in different economic sectors or markets are compared.

<u>The other method</u>

The other method was made effective by notifying Rule 10AB in Income Tax Rules, 1962 ('the Rules') from assessment year (AY) 2012-13. The other method is not one of the prescribed methods by OECD TP Guidelines.

The Other Method is applied in cases where data in respect of price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transactions which is comparable to the controlled transaction undertaken by the taxpayer is readily available.

The Other method was introduced to remove practical difficulties in arriving at ALP, particularly in cases where quotations, stock exchange prices or valuation reports are relied upon by the taxpayers to compute the ALP of the controlled transactions. This is because, the CUP method only takes into account the price paid or charged in transactions which are actually undertaken and does not provide for price which would have been charged in similar uncontrolled transactions. Accordingly, tax authorities rejected the application of quotations or valuation reports as CUP prior to introduction of the other method. However, in several judicial precedents (Gulf Energy Maritime Services (P) Ltd, Adani Wilmar Limited [TS-114-HC-2014(GUJ)-TP]) the courts / tribunals did accept quotations as external CUP.

3. Selection of tested party

The Indian TP regulations do not provide for concept of selection of tested party for transfer pricing benchmarking. Such concept is given internationally by OECD TP Guidelines.

The concept of tested party is extremely important as the price / margin in a controlled transaction is to be tested with reference to either taxpayer or its AE for comparing the same with uncontrolled comparable transaction.

As per OECD TP guidelines, selection of tested party should be based on factors like:

- Least complex party to the controlled transaction
- Party taking minimum / negligible risks in a controlled transaction
- Party not owning or contributing any unique intangibles to the international transaction
- Party whose data can be tested with minimal economic / comparability adjustments
- The comparable data in respect of the party is readily available and can be reliably used to arrive at arm's length price

Based on the above factors, the taxpayer can select either itself or its AE as a tested party.

The tax authorities in the past have rejected selection of foreign AE as a tested party. However, ITAT benches in *General Motors India Pvt. Ltd. vs. DCIT* (ITA. Nos. 3096 / Ahd. / 2010 and 3308 / Ahd. / 2011) and Tata Motors European Technical Centre Plc (ITA.No.7630 / Mum. / 2012 ITA.No.1698 / Mum / 2014) have permitted the use of foreign AE as tested party for purpose of ALP determination, in case the relevant data in respect of such tested party and comparables are made available to the tax authorities or are available in public domain.

4. Application of TP methods

Once a particular method is selected as MAM, the taxpayer then needs to apply that method for computing the ALP.

In this section, we will analyse the application of each and every method.

CUP

Once the CUP has been selected as MAM, the price in controlled transaction is to be compared with price in uncontrolled transactions. If price in uncontrolled transactions is affected by certain differences then, such differences needs to be adjusted. For example: price in uncontrolled transaction may be imputed with marketing expenses which may be absent in case of uncontrolled transaction. It is reiterated that, CUP is a rigid method as far as comparability of products / services is concerned, hence it should be selected as MAM only when it is feasible to adjust differences through economic adjustments.

Further, the price of certain products may fluctuate frequently and hence, the comparable uncontrolled transactions should pertain to the same or near date as that of controlled transactions for such products. E.g: food, oil prices etc.

Use of multiple year data is not allowed while applying CUP method to the controlled transaction under consideration on account of the fact that, prices may fluctuate over time.

It also needs to be noted that, controlled transactions cannot be aggregated and their prices cannot be averaged so as to compare such average price with price of comparable uncontrolled transaction. Hence, each of the controlled transaction needs to be compared with the uncontrolled transactions. In this regard, the ITAT Delhi bench in the case of Tilda Riceland (ITA No.: 6279 / Del / 2012) has observed as under:

"under CUP, the ALP of the transactions with the AEs cannot be determined by comparing average export price by the assessee to its AEs with the average uncontrolled export price because while under rule 10B (1)(a)(i) it is open to compute ALP on the basis of price charged in a comparable controlled transaction or 'a number of such transactions', the ALP so computed is, under rule 10B(1)(a)(iii), taken as ALP in respect of property transferred in the international transaction. The expression 'the international transaction' referred to in rule 10 B(1)(a)(iii) is used in singular and does not permit taking into account, unlike rule 10B(1)(a)(i), 'a number of such transactions'. While averaging is thus permissible for the uncontrolled transactions, each international transaction is to be taken on standalone basis. It is not open to the assessee to compare the average price in his transactions with AEs with average price in uncontrolled transactions."

However, the price data in respect of uncontrolled transactions comparable to a controlled transaction(s) can be compiled into inter-quartile range for the purpose of computing the arm's length range.

RPM

RPM involves comparison of gross profit margin earned on resale of goods purchased from AEs to end customers with the gross margin earned in respect of similar uncontrolled trading transactions in public domain or undertaken internally within the taxpayer's MNE group.

As RPM is applicable only to controlled transactions which are purely trading in nature, the only expenses which would form part of cost base for computing the gross margin are purchase price of goods from AEs and the expenses incurred in connection with such purchases e.g: logistics expenditure, employee and other administration cost relevant to purchase of goods. It would be important for taxpayer to demonstrate the link between such other expenses and the purchase of goods from AEs. In some cases, where direct expenses in relation to purchases cannot be readily identified, on account of being aggregated with other expenses of similar nature, allocation key can be used to indirectly attribute such expenses to cost base to arrive at gross margin on resale.

Further, economic adjustments may be undertaken for adjusting any differences in controlled transaction vis-à-vis uncontrolled transactions arising on account of differences in functions, risks or accounting practices.

RPM can be applied using multiple year data and by compiling inter-quartile range of comparable uncontrolled prices, if applicable and subject to rule 10CA.

CPM

CPM in its application is similar to RPM as it involves comparison of gross profit margin earned from controlled transaction with the gross margin earned in similar uncontrolled transactions. However, CPM is applied to test the gross margin earned from sale of goods/ provision of services to AEs. Also, the cost base for application of CPM consists of direct or indirect costs incurred by the enterprise in respect of goods sold or provision of services to AEs.

In many cases, tax authorities have alleged that, CPM is not applicable as indirect costs in respect of particular transactions is not available. In this regard, it is to be noted that, computation of gross margin may not encompass entire class of indirect costs, as including all the indirect costs may lead to computation of net margin instead of gross margin. However, the manufacturing overheads may be categorised as indirect costs. In case, there are no indirect costs available in relation to controlled transaction then, gross margin is to be computed only by subtracting direct costs from sales price.

Practically CPM is not applied frequently as taxpayers contend that that, it is difficult to readily ascertain the gross margin (from published audited financial statements) earned by comparable entities operating in the industry. However, the author is of the view that, such exercise can be performed by the taxpayer or tax professionals by selecting a particular cost item as relevant expense for arriving at arm's length gross profit margin. Similar exercise can be performed while arriving at gross margin for application of RPM.

Like RPM, relevant economic adjustments needs to be undertaken to adjust the differences between controlled transaction and uncontrolled transactions while applying CPM. Similarly, multiple year data and range concept can be applied while arriving at ALP using CPM.

PSM

Out of all the TP methods, PSM is the only method which is seldom applied by the taxpayers, tax professionals and also tax authorities. This is because, PSM requires data in respect of all the parties to the transaction to arrive at combined profits to be split. Often obtaining data in respect of all the parties to the transaction is difficult. Further, even if such data is made available, practical difficulties like differences in accounting policies/standards in respect of different entities in the transaction make it difficult for combined profits to be computed. Further, there are also difficulties in identifying the relevant costs incurred by the parties in relation to controlled transaction.

PSM can be applied in two ways i.e. a) contribution analysis or b) residual analysis.

Contribution analysis can be applied by aggregating the profits earned by the parties to the controlled transaction and then splitting such profits in a manner which would reflect the contribution of the each party to the controlled transaction. Generally, the profits are split using a particular allocation key which represents the value driver in a particular transaction. For example: profits arising from sales of blockbuster drug developed by two or more parties can be split between the parties in ratio of the value of their respective contributions to the development of the drug. Thus, value of contribution made by parties is the allocation key used for split of parties.

The residual analysis is a two-step process. The first step entails remunerating the entities performing the routine activities in the entire transaction with a routine return. Such benchmarking of routine return is performed using the RPM, CPM or TNMM. The residual profits are then split between the parties to the arrangement who have made unique contributions to the transaction using appropriate allocation key.

It needs to be kept in mind that, use of multiple year data and inter-quartile range is not allowed in case the PSM is selected as MAM.

TNMM

One of the easiest methods to apply is TNMM. Hence, majority of cases these days are benchmarked by using TNMM.

TNMM involves comparing the net profit margin earned by taxpayer in the controlled transaction with the net profit earned by taxpayer in the uncontrolled transaction. The net profit margin is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base. In case of asset incentive industries (for example: ports or mines etc.), the assets or capital employed may be relevant base for computing the net profit margin.

Further, only operating expenditure needs to be considered for arriving at the cost base. Such expenditure should exclude the costs relevant to financial transactions or the extraordinary costs (for example: retrenchment costs) which are not linked to the controlled transactions.

Also like CPM and RPM, relevant economic adjustments needs to be undertaken to adjust the differences between controlled transaction and uncontrolled transactions while applying TNMM. Similarly, multiple year data and range concept can be applied while arriving at ALP using TNMM.

The Other Method

The Other Method is applicable in cases where none of the other five methods can be reliably applied and it is possible to arrive at the price which would have been charged or paid in similar comparable uncontrolled transactions so as to compute arm's length price.

Such method is applied by use of quotations, valuation reports or stock exchange prices.

Further, it is important to note that, use of multiple year data and inter-quartile range is not allowed in case the other method is selected as MAM.

Link between net profit margin/gross profit margin and ALP computation

From the discussion, it can be inferred that, in case the gross profit margin (for CPM and RPM) or net margin (for TNMM) is at arm's length then, all the items in the profit and loss account are at arm's length and accordingly, the price at which international transaction and specified domestic transaction is undertaken automatically meet the arm's length test.

5. Aggregation v. Segregation

One of the most common TP controversies is around aggregating two or more controlled transactions for the purpose of benchmarking or testing the arm's length price of each transaction separately.

Rule 10A(d) of the Rules defines transaction to includes a number of closely linked transactions.

While the aggregation cannot be used while applying CUP or the Other Method which provide for comparing the price in particular controlled transaction with price applied in uncontrolled transactions, the aggregation approach for aggregating the closely interlinked transaction can only be applied in CPM, RPM, PSM and TNMM.

Further, onus to demonstrate that, transactions are closely interlinked lies with the taxpayer. In the past, the ITAT has rejected the aggregation approach adopted by the taxpayers if the taxpayer was unable to justify the transactions were closely interlinked. *(Refer UCB India Pvt. Ltd. (317 ITR 292 (AT)(Mumbai), Star (I) Pvt. Ltd. vs. ACIT [2008-TIOL-426-ITAT-Mum]).*

However, in case of *Avery Dennison (India) Pvt. Ltd. [TS-527-HC-2016(DEL)-TP],* the ITAT has allowed the aggregation of controlled transaction of receipt of services with the international transaction of sale of goods by holding that, taxpayer was predominantly a manufacturer and that services received by taxpayer from its AEs were intrinsically linked to core business operations.

Further, such aggregation was also allowed by the ITAT in the cases of *Luwa India Pvt. Ltd. [TS-687-ITAT-2016(Bang.)-TP]* and *McCann Erickson India Pvt. Ltd [ITA No.5871/Del./2011]* where taxpayer was able to demonstrate that, two or more controlled transactions are closely interlinked.

6. Rejection of taxpayer's benchmarking by AO/TPO

The ALP determined by the taxpayer cannot be simply rejected by the AO/TPO. The AO/TPO has to examine the benchmarking exercise conducted by the taxpayer to examine as to whether the ALP determination by taxpayer is in line with TP regulations.

The TPO [under section 92CA(3)] or AO [under section 92C(3)] can only reject the ALP computation of the taxpayer <u>if on the basis of material, information or document in his/her possession, he/she is of the opinion that</u> :

a) The ALP has not been determined by the taxpayer as per TP regulations

b) The taxpayer has not maintained required transfer pricing documentation or adequate information in respect of the controlled transaction

c) The information or data used by the taxpayer for computation of ALP is not reliable or correct

d) The taxpayer has failed to furnish the information called by the AO/TPO

The word information has been judicially defined by Supreme Court in the Case of *CIT vs. Raman & Co. (67 ITR 11 SC).* As per the Apex Court, the word information means 'instruction or knowledge derived from an external source or from materials on record'. Further, as per *noscitur a socciis* principle of interpretation, meaning of words 'material' and 'document' take colour from the word 'information'. This is because, where two or more words which are susceptible of analogous meaning are coupled together, noscitur a sociis, they are understood to be used in their cognate sense *[Commissioner of Income Tax vs. Bharti Cellular Ltd. (I.T.A. 1120/2007)].* Hence, any 'material' or 'document' relied upon by the AO/TPO while rejecting the assessee's method/comparable should also be derived from external source or material already on record.

Further, it needs to be noted that, the AO/TPO needs to form an opinion based on the material, information or document as to why the benchmarking analysis performed by the taxpayer should be rejected.

As words of the statute require formation of opinion on part of AO/TPO, any rejection of taxpayer's benchmarking requires application of mind on part of AO/TPO. Further, AO/TPO needs to record his reason in writing before rejecting taxpayer's benchmarking.

Courts in several cases have quashed the TP assessments wherein the TPO have rejected the benchmarking analysis conducted by the taxpayer without giving cogent reason. In Indo American Jewellery I.T.A. No. 6194/Mum/2008 ITAT Mumbai held that, TPO/AO cannot reject the transfer pricing benchmarking exercise/documentation prepared by the taxpayer without providing any cogent reasons. The judgment has been upheld by Bombay High Court.

It needs to be noted that, circular 3/2016 has narrowed down the role of AO in conducting the TP assessment to (i) referring the international transaction or specified domestic transaction to TPO and (ii) passing draft/final assessment order in conformity with the order passed by TPO, as the circular 3 has provided as under:

"3.7 For administering the transfer pricing regime in an efficient manner, it is clarified that though AO has

the power under section 92C to determine the ALP of international transactions or specified domestic transactions, determination of ALP should not be carried out at all by the AO in a case where reference is not made to the TPO. However, in such cases, the AO must record in the body of the assessment order that due to the Board's Instruction on this matter, the transfer pricing issue has not been examined at all."

7. TP adjustments

The TP adjustments can either be the adjustments done by AO / TPO to the ALP determined by the taxpayer or the adjustments done by taxpayer itself *(suo-motu)* to its controlled transaction so that the transaction value represents ALP.

In this section, we will understand few tax aspects in relation to TP adjustments:

Allowability of 10A / 10AA / 10B / Chapter VI deductions on TP adjustments

This is one of the most frequently asked questions by both taxpayer and tax practitioners as to whether the deduction would be allowed on the amount of TP adjustment in cases where deductions have been availed with respect to special provisions for SEZ and other eligible units.

In this regard, it is to be noted that, proviso to section 92C(4) provides that, no deduction under section 10A or section 10AA or section 10B or chapter VI will be allowed in respect of amount of income by which total income of the taxpayer is enhanced by AO / TPO on account of TP adjustment. Therefore, a plain reading of provisions suggest that, no deduction would be available on the amount of adjustments.

However, if the taxpayer returns additional income by the way of *suo-motu* adjustment, whether such *suo-motu* adjustment is allowed as a deduction. We will analyse this aspect in the subsequent section.

Suo-motu adjustment

As per section 92(3) of the Act, the taxpayer cannot substitute the actual price of the controlled transaction with arm's length price, if the computation of arm's length price would result in reduction of income of the taxpayer or increasing the loss.

Hence, *suo-motu* adjustment to the income of the taxpayer can only be made if such adjustment results in increase in taxable income of the taxpayer or reduction in allowable loss.

Whether section 92C(4) or 92(3) will restrict the taxpayer from claiming the deduction under special provisions for SEZ and other eligible units in respect of income added by the way of suo-moto adjustment?

In this regard, it is to be noted that, section 92C(4) only restricts the deduction when the income is enhanced by AO / TPO on account of TP adjustment. The Bangalore ITAT in case of I Gate Global Solutions v ACIT (24 SOT 3) where the taxpayer itself did *suo-motu* adjustment to ALP prior to availing the 10A deduction in its return of income observed that

"from the literal meaning of the word 'enhanced', it is clear that if income increased, as a result of computation of arm's length price, then such increase is not to be considered for deduction under section 10A. In the instant case, the assessee himself has computed the arm's length price and has disclosed the income on the basis of arm's length price. It is not a case, where there is an enhancement of income due to determination of arm's length price. Hence, it is held that assessee was entitled to deduction under section 10A in respect of income declared in the return of income on the basis of computation of arm's length price."

The decision in case of I Gate Global Solutions (supra) has been upheld by Karnataka High Court (HC) in ITA No.453 / 2008 dated 17-6-2014. Further, the ITAT order merged with HC has been followed in the cases of Austin Medical Solutions Pvt. Ltd. [ITAT Bangalore TS-348-ITAT-2015(Bang)-TP] and by Mumbai bench of ITAT in case of *Agilisys IT Services India Pvt. Ltd. [TS-198-ITAT-2015(Mum)-TP].*

However, in the case of Deloitte Consulting India P. Ltd. [TS-551-ITAT-2012(Mum)], the Mumbai Bench of ITAT observed that, voluntary transfer pricing adjustment in ALP has no nexus with software development activity and hence, section 10A deduction not available on voluntary TP adjustment. In this regard, it needs to be noted that, any TP adjustment is just the valuation of arm's length income which taxpayer should have earned in a particular transaction and such adjustment takes the character of the transaction it relates to / emanates from. Hence, the *suo-motu* adjustment is just to estimate the arm's length income which should have been earned out of eligible undertaking / business of the taxpayer and has direct nexus with the eligible unit.

8. Base erosion theory and new Special Bench ruling in the case of Instrumentarium

The base erosion concept is applicable when the deduction of payment is made by one entity for computing its taxable income in India and the income earned by other entity in respect of such international transaction is also taxable in India.

Let us understand through example how the base erosion concept is applied by taxpayers / tax professionals and rationale behind such concept.

Company A, a tax resident in India makes a payment of technical service fees amounting ` 100 to Company B, which is non-resident entity in India for tax purposes. As per section 195 r.w. section 115A / section 90(2) (tax treaty), the Company A withholds tax to the tune of 10% i.e. 10 and makes balance payment of 90 to Company B. Company B files return of income in India. Company A aggregates the technical services with its sale transactions (as technical services were used for manufacture of the product) and benchmarks the technical services transaction using TNMM by contending that, net profit margin of 15% made by it exceeds the net margin made by comparables operating in similar industry. Company B prepares the TP report contending that, Company A is earning arm's length profit margin and paying tax at the rate of 30%, while Company B is paying tax at the rate of 10%, hence any adjustment to the price earned by Company B will cause Company A to make additional payment to Company B resulting in additional tax deduction, thus reducing the effective tax rate at which Company A would pay its tax. Also overall tax paid by the MNE group in India would reduce.

Thus, the rationale behind the base erosion theory is that, any transfer pricing adjustment to the price earned by non-resident entity, the income of which is withheld at a withholding tax rate lower than corporate tax rate would affect the overall tax paid by MNE group in India leading to erosion of Indian tax base.

One of the important points which tax professionals have been ignoring for long time is that, income tax act does not contain the provisions for corresponding adjustment. Hence, if the TP adjustment is done by tax authorities to price earned / paid by one entity then, the corresponding adjustment cannot be made to the income of the other entity which is party to the transaction. This often leads to economic double taxation which has no remedy under the Act. While Article 265 of the Indian Constitution provides that, Indian Government cannot collect tax which it is legally not entitled to collect, unfortunately such Constitutional provision has not been carried to logical end by providing for provision in respect of corresponding adjustment in respect of transfer pricing adjustments under the Act. However, such corresponding adjustment can be made through mutual agreement procedure (MAP) between two competent authorities through tax treaties.

Also it needs to be noted that, base erosion concept cannot be carried to its logical end even in case where *suo-motu* adjustment is performed because, under section 92(3), the downward *suo-motu* adjustment is not allowed. Hence, in above example, on account of section 92(3), downward adjustment could not have been made to Company A's income by enhancing deduction, if the price earned by Company B was found to be less than arm's length price resulting in *suo-motu* adjustment to the taxable income of Company B.

Base Erosion concept has been recent subject of TP controversy on account of ITAT Special Bench ruling in the case of Instrumentarium [ITA Nos. 1548 and 1549/Kol/2009].

Instrumentarium Corporation Limited, a Finland based Co. (hereinafter referred as F Co.) granted interest free loan to its Indian subsidiary (I Co.). Before tax authorities the F Co. contended that, imputing notional interest income would lead to erosion of Indian tax base as the net result will be:

- A withholding tax of 10% on the interest payable;
- A statutory reduction or deductibility of the said expenses in hands of I Co. which will allow benefit of 36.75% tax;
- A resultant base erosion of 26.75% to the Indian revenue.

Further, the F Co. relied on CBDT circular No. 14 of 2001 which stated that, TP provisions are not to be applied in cases which would lead to erosion of Indian tax base and where adoption of arm's length price will result in a decrease in overall tax incidence in India in respect of parties involved in the international transactions.

The Special Bench of ITAT rejected the contention of the F Co. by observing that, there are no provisions for corresponding adjustment in Indian Income-tax Act and in-fact section 92C(4) restricts such corresponding adjustment made in consequence to TP adjustment. Hence, I Co. could have not made tax deduction on account of adjustment in hands of F Co. Therefore, there would be erosion of Indian tax base.

Further, ITAT rejected the reliance placed by the F Co. on CBDT circular by observing that, it states intent of the legislature and is not an order to be followed by tax authorities.

In view of the author, this case law is a learning lesson for all tax professionals as it has once again reiterated that, the TP regulations which are part of Income-tax Act are to be read both literally and strictly without inserting legislative intent or effect of provisions. Base erosion as concept was attempt of imputing new machinery provisions in Income tax act without realising the basic principles of reading of tax statute that, nothing can be added or subtracted from wordings of law. Accordingly, proviso to section 92C(4) and even 92(3) are to be read literally, without going into intent or overall effect of the provisions. There is no enabling provision of corresponding adjustment and therefore one cannot impute base erosion concept in law. Hence, this is classic case of lack of machinery provisions. One has to understand that, any computation which section 92(1) talks is for particular assessee, the law does not address the situations for both payee and payer together.

9. Economic adjustments – Whether to make adjustments on comparables or tested party?

Rule 10B(1) of the Rules provides that, relevant economic adjustments is to be made to comparable uncontrolled transaction while applying each of the prescribed method to adjust for any accounting or other functional differences, so as to eliminate the material effects of such differences on the arm's length price.

Some of the common types of economic adjustments are capacity utilisation adjustment, risk adjustment, depreciation adjustment, customs duty adjustment, working capital adjustment, abnormal cost adjustment and forex adjustment.

While methodology for computation of these economic adjustments can form a topic of a separate article, we will briefly discuss one of the most widely debated topics as to whether the economic adjustments is to be made to the price/margin of comparables or the tested party.

The rules provide that economic adjustments are to be made to the comparable uncontrolled transactions so as to adjust the impact of the differences between uncontrolled and controlled transactions on arm's length price / margin.

However, we often find the taxpayer adjusting its own price / margin while conducting the economic adjustments, so as to make its price / margin comparable to arm's length price. The reasoning is that, as the data in respect of taxpayer is internally available and as taxpayer is better aware about such data to be compared to comparable information which is from external sources, any adjustment can be easily made and reliably justified.

The tax authorities have been adopting the stringent interpretation of Rule 10B(1) to contend that, economic adjustments are admissible only if made to comparable price / margin.

The ITAT Benches have taken a strict view in the cases of *JCB India Limited [TS-260-ITAT-2015(DEL)-TP]* and *Claas India Pvt. Ltd. [TS-371-ITAT-2015(DEL)-TP]* by observing that, action of the taxpayer making economic adjustment to its own controlled price / margin is devoid of any statutory provision.

However, ITAT Pune Bench has taken a contrary view in the case of *Ariston Thermo India Limited [TS-221-ITAT-2013(PUN)-TP]* by rejecting the stand taken by tax authorities that, adjustment is permissible only to margins of comparable companies and not to that of tested party. The ITAT in this case allowed the capacity utilisation adjustment to be made while computing the taxpayer's own margin.

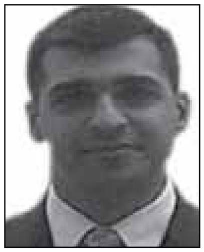
In view of the author, the statutory legislation which is Income-tax Act does not provide for or restricts the application of economic adjustments either to comparable or tested party's price / margin. The chief machinery section 92(1) provides that, any income or expense from an international transaction or specified domestic transaction should be computed having regards to arm's length price. The words 'having regard to' means the taxpayer has to consider all relevant circumstances while computing the arm's length price. *[Juggilal Kamlapat Bankers vs. WTO (145 ITR 485), CIT vs. Gangadhar Banerjee & Co. (Private) Ltd. (57 ITR 176), CIT vs. Raman & Raman (P.) Ltd. (110 ITR 747)].* One may interpret that, section 92(1) itself allows the taxpayer to make economic adjustments whether or not the rules providing for the same exists. Section 92(1) which is statutory provision would override the Rule 10B(1) which is delegated legislation. One may harmoniously interpret to say, both adjustments to tested party's price / margin or comparable price / margin should be permissible as both are made with an objective to arrive at arm's length price.

10. Conclusion

Computation of ALP does not involve just selection of MAM and applying such method. It also involves an extensive exercise which encompasses selection of tested party, undertaking FAR analysis, comparability analysis (including undertaking comparability adjustments) and economic analysis so as to arrive at ALP and verifying as to whether such transaction meets arm's length test or whether *suo-motu* adjustment is required. Further, it also involves analysis of whether the controlled transaction is to be benchmarked on standalone basis or whether such transaction is to be aggregated with other controlled transactions.

In this article, we have tried to analyse some of the important facets for computation of ALP. However, as TP analysis being an art, the topics discussed in this article are not exhaustive in nature. Several of the related topics (or topics discussed above) will be discussed in more detail in other articles of this journal issue.

Needless to say that, following a scientific process for computation of ALP would enhance the reliability of such exercise to withstand the rigorous TP audit conducted by tax authorities.

CA Maulik Doshi & CA Kamlesh Kaltari

Developments in Computation of Arm's Length Price – Bane or Boon?

Precursor

For determining the arm's length price the range concept has been widely used globally and adopted considering business reality coupled with the fact that in most cases the application of the most appropriate method could result in a range of prices which may all be at arm's length.

However, in the Indian context there is abundant evidence to support the fact that there has been never ending litigation and debate between the revenue authorities and the taxpayers on the applicability / acceptability of an arm's length 'range' (both in practice and as a concept) that is accepted globally. Till recently, despite various representations, the Government preferred arithmetic mean and had continued to shy away from dismissing the arithmetic mean as against adopting the inter-quartile range which has been embraced by OECD and globally by most of the countries. At this point the law includes both the arithmetic mean (with a tolerance limit) as well as the newly introduced range concept.

1. Arithmetic Mean or Median in Indian context

1.1 One of the issues that exist while evaluating the arm's length price is whether the arithmetic mean or median is to be used from the dataset of comparable uncontrolled transactions / prices / profit margins. In this context the section 92C(2) of the Income-tax Act, 1961 ("the Act") reads:-

> *(2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed:*
>
> *Provided that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:*

1.2 The proviso specifically mentions the fact that in cases where there are more than one price determined by the most appropriate method the arm's length price would be determined by the arithmetical mean of such prices. This can be understood as follows:-

Selection of Most Appropriate Method

↓

Based on the result on the application of the most appropriate method if there is only 1 comparable uncontrolled price or comparable profit margin available, then that price or margin would be the arm's length price.

↓

However, if there is more than 1 comparable uncontrolled price or comparable uncontrolled profit margin available then the arithmetic mean of such prices or margins would be the arm's length price.

Accordingly, it can be seen that as such the concept of median is not prescribed and arithmetic mean is preferred.

1.3 There exists another anomaly in this situation where one may be challenged with the decision to adopt either – simple average or weighted average. On a plain reading of the proviso and other part of the sections and rules it would seem that the law intends to apply the arithmetic mean which is the simple average price. However, Rule 10B(3) of the Income-tax Rules, 1962 ("the Rules") states:–

> *An uncontrolled transaction shall be comparable to an international transaction (or specified domestic transaction) if –*
>
> *(i) None of the differences, if any, between the transactions being compared, or between the enterprises entering into such transaction are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or*
>
> *(ii) Reasonably accurate adjustments can be made to eliminate the material effects of such differences.*

1.4 Transfer pricing is a very contentious subject and as such whichever method is determined as the most appropriate method, very rarely would an assessee get absolute comparable prices / margins. In cases where there are differences in the uncontrolled transaction that may not be comparable to the international or specified domestic transaction, adjustments are allowed to smoothen out such differences. One such way of levelling the comparability would be on applying the **weighted average prices** of the uncontrolled transactions.

Example:–

Sale of goods	Quantity	Rate	Amount
Price between related parties	1000	95	9,500

Uncontrolled Transactions	Quantity	Rate	Amount
1	1000	97.00	97,000
2	5000	93.00	465,000
3	100	100.00	10,000
4	450	100.00	45,000
5	200	100.00	20,000
6	2000	95.00	190,000
Total	**8750**		**8,27,000**

The simple average of the 6 uncontrolled transactions would come to 97.51 which would make the rate charged by the assessee to the related party (i.e. 95) lower than the arm's length price. However, if we were to take the weighted average price (i.e. Total Amount/Total Quantity of the 6 uncontrolled transactions) the arm's length price would be ` 94.51. This is more so as the rates charged for higher volumes are lesser than the rates charged for lower volumes, and as such the weighted average computation would take the volumes into consideration.

2. Availability of Tolerance Limit

2.1 The arm's length concept under transfer pricing propagates that the transfer prices between associated concerns must be proved to be as if concluded if the parties to the transaction were not related. However, in a practically it is not always possible to identify open uncontrolled prices especially where the transactions relate to services or where intangibles are involved. The second provision to section 92C of the Act, before Finance Act, 2011 did not specify the percentage of variation to be allowed in arm's length price. In this background, the Finance Act, 2011 substituted the words *"such percentage of the latter" for "five percentages of the latter"*.

2.2 Subsequently, the Finance Act, 2012 inserted the words, "*not exceeding three per cent*" w.e.f. 1st April, 2013. In other words, adjustment for the purpose of arm's length price shall only hit when the arm's length price is not within the given tolerable range.

2.3 Accordingly, in continuation to the reading of the section 92C(2) of the Act as of today the section further provides for the following:-

Provided further *that if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage not exceeding three per cent of the latter, as may be notified by the Central Government in the Official Gazette in this behalf, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price.*

2.4 To explain this concept and in continuation of the example given earlier (2.4) the computation of the 3% tolerance limit is as follows:-

Price Charged between related parties for sale of goods (A)	95
Uncontrolled Price (using Simple Average) (B)	97.51
Variation (C = B-A)	2.51
Variation / Price Charged between related parties (C / A)	2.64%

Accordingly, as the variation between the related transaction and the uncontrolled transaction is less than the 3% tolerance limit the price charged (i.e. ` 95) can be said to be at arm's length.

2.5 In connection with the above the latest Notification No. 57/2016 dated 14th July, 2016 provides that:- *"Where the variation between the arm's length price determined under section 92C and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed* ***one per cent of the latter of wholesale trading and three per cent of the latter in all other cases,*** *the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for the assessment year 2016-17."*

The notification has specifically pegged the variation for wholesale trade at 1% and defined the term wholesale trade as:-

"An international transaction or specified domestic transaction of ***trading of goods,*** *which fulfils the following conditions, namely:-*

(i) Purchase cost of finished goods is ***eighty per cent or more of the total cost*** *pertaining to such trading activities;* ***and***

(ii) ***Average monthly closing inventory is ten per cent or less*** *of sales pertaining to such trading activities.*

The notification clarifies that in case the variation between the arm's length price and the international or specified domestic transaction is within the 1% or 3% tolerance band the transaction can be deemed to be at arm's length. There would not be any other variation.

In order to check whether a 3% variation is allowed for a distributor one needs to exhaust the possibility of falling in the conditions as a "wholesale trader". Accordingly, from the point of view of a trader the following points would emerge

- What constitutes "purchase cost"? – only purchase value or other direct costs incurred for the purpose of acquisition;
- Traders to maintain monthly closing inventory details.

2.6 Further, for removal of doubts, section 92C of the Act provides the Explanation that the proviso of tolerable range shall also be applicable to all assessment or reassessment proceedings pending before an AO as on 1st October, 2009.

3. Multiple Year Data & Range Concept

3.1 The introduction of the CBDT's Notification No. 83 dated 19th October, 2015 has been a positive development in the Indian transfer pricing scenario. The Ministry has attempted at detailing the manner of computation of arm's length price which would surely be of assistance to the assessee in highly contentious cases and otherwise.

3.2 The Finance (No. 2) Act, 2014 had inserted a proviso to section 92C(2) of the Act where it states that the above two explanations (i.e. use of arithmetic mean and tolerance limit) would not be applicable in prescribed situations. This is seen as a positive signal to investors, the CBDT has amended rules for determination of Arm's Length Price with aim to provide clarity in calculating prices in transfer pricing cases and reducing transfer pricing litigations. This is elaborately explained in Rule 10CA(2). This new regime will be applicable for computation of ALP of international transactions and specified domestic transactions undertaken on or after 1st April 2014. The key changes observed in final rules are as under:

Use of Multiple Year Data

3.3 In the final notification – the single year, i.e. current year regains the importance since if a company is not considered to be a comparable for current year, then it is out from the computation, without looking at whether it satisfied comparability criteria for past 2 years or not. The final notification provides that if the data for current year is not available for a company, you can go back in the immediately preceding year and consider whether it is comparable or not. If yes, you will go further and see whether it is comparable for the second preceding year and accordingly, you will use weighted average data for last year and last to last year.

3.4 The relevant Rule 10CA(3) also seems to indicate that in cases the most appropriate method determined is the Resale Price Method, Cost Plus Method or the Transactional Net Margin Method only then the assessee can / must use the multiple year data (i.e. weighted average of three year data).

Method Selected	**Rules prescribed for manner of computation of ALP**
Resale Price Method	Weighted average prices by assigning weights based on the ***quantum of sales*** used for arriving at the respective prices
Cost Plus Method	Weighted average prices by assigning weights based on the ***quantum of costs*** used for arriving at the respective prices
Transactional Net Margin Method	Weighted average prices by assigning weights based on the *profit level indicator (i.e. sales, costs, assets, etc.)* used for arriving at the respective prices

3.5 The data required to be used for comparability analysis was required to be relating to the 'financial year' or data relating to not more than two years prior to current in which the transaction was entered into. Rule 10B also states that in case the data relating to the current year is not available at the time of furnishing return of income, & if the method used for determining ALP is either Resale Price Method, Cost Plus Method or TNMM, then comparability will be conducted on the basis of the data relating to financial year immediately preceding the current year. However, if the current year data becomes available during the assessment proceedings, the same shall be considered irrespective of the fact that it was not considered at the time of furnishing return of income.

3.6 **Apprehensions for adoption of the Multiple Year:** The adoption of multiple year data as such may seem beneficial but it has it own set of challenges. For instance at the time of concluding a transfer pricing study (i.e. prior to entering into the transaction) or benchmarking the transaction (i.e. prior to the filing of the return of income) it may so happen that there may not be sufficient information for companies that would cause companies to be accepted / rejected. Further, when being scrutinised by the tax office (two years down the line); the latest three year data for the shortlisted comparable companies would be available and as such the final list of companies could possibly undergo a change. Accordingly, there is a possibility that the result of the benchmarking study may get skewed.

Example:–

At the time of conducting the transfer pricing study there are 9 companies identified to be comparable that pass the relevant search criterias, filters and comparability parameters. However, these nine are included in the final set as follows:-

No.	Mar-2016	Mar-2015	Mar-2014
Company 1	Not Available	Available	Available
Company 2	Not Available	Available	Available
Company 3	Available	Available	Available
Company 4	Not Available	Available	Available
Company 5	Not Available	Available	Available
Company 6	Not Available	Available	Available
Company 7	Available	Available	Available
Company 8	Available	Available	Available
Company 9	Not Available	Available	Available

However, at the time of transfer pricing assessment in case the companies whose Mar-2016 data (that were earlier not available); subsequently become available the evaluation of the comparability of the latest year information would be critical. There are possible scenarios where those companies that were earlier acceptable may not be comparable based on Mar-2016 data thereby reducing the final list to less than 6. Accordingly, the approach of range may change to arithmetic mean or more so the range also may change due to the computation of margins based on Mar-2016 data.

Adoption of Range Concept

By introducing the range concept in the Indian arena, the Government has considered the internationally accepted best practice of using the inter-quartile range in spirit for determining the arm's length price.

3.7 Number of comparables to apply range mechanism

In the draft proposed rules, CBDT stated that the range concept would apply only where **nine or more companies** are selected as comparable, and where inadequate comparable companies exist, the arithmetic mean concept would continue to apply. However, the final rules have given some relief to taxpayer by reducing the minimum number of comparable companies from minimum of 9 to 6 or more companies. This is welcome change proposed by the CBDT as there are industries in India such as manufacturing, specific services etc. wherein it would be difficult for the Indian taxpayer to identify a good comparable set comprising of 9 or more comparable companies which was proposed in draft rules.

3.8 Range specification

In order to adopt the range concept the most appropriate method determined would need to be Comparable Uncontrolled Price Method, Resale Price Method, Cost Plus Method or the Transactional Net Margin Method only. The range concept will be applicable for determining the price and will begin with the 35th percentile and end with the 65th percentile of the comparable prices. Although, the draft rules were proposing 40th to 60th percentile of the data set of series. In this regards, it has been observed that CBDT has tried to match-up with inter-quartile range internationally practised is 25th to 75th percentile of the results.

3.9 Transfer Price out of arm's length range

In the final notification, it has been constructed that if the price at which the international transaction or the specified domestic transaction has been undertaken, is outside the arm's length range so as constructed using the dataset, then the arm's length price shall be taken to be the median of such data set for the purpose of computation of adjustment.

3.10 Use of arithmetic mean

As per the final notification, when the numbers of comparable so as constructed in dataset are lesser than 6, the arm's length price shall be computed using multiple year data, then instead of range, arithmetical mean of all the values included in the data set shall be computed to arrive at ALP also deviation of +/- 3% will be allowable in such cases. However, if Range Concept is used (i.e. if the number of companies is more than 6 in number) then the variation of 1% or 3% would not be applicable.

3.11 In a nutshell the process of adoption of the range concept is listed below:-

Step 1: Determine the most appropriate method – The range concept would be applicable only if the International Transaction / Specified Domestic Transaction is benchmarked using the following methods only:-

- Comparable Uncontrolled Price (CUP) Method
- Resale Price Method (RPM)
- Cost Plus Method (CPM)
- Transactional Net Margin Method

Accordingly, the rules have specially excluded the use of range concept when the Profit Split or Other Method is being used. In these situations the ALP will be determined based on the arithmetical mean of all the prices included in the dataset and the assessee will be able to avail the benefit of tolerable range of 3% (or 1% in case of wholesale traders).

Step 2: Number of Comparable Companies required in the data set: Only if the number of comparable uncontrolled 'entries' are 6 or more in number would the range concept be allowed to be used.

Accordingly, the rules have specially excluded the use of range concept where the number of comparable uncontrolled 'entries' are less than 6 (irrespective of the method) being used. In these situations also the ALP will be determined based on the arithmetical mean of all the prices included in the dataset and the assessee will be able to avail the benefit of tolerable range of 3% (or 1% in case of wholesale traders).

Step 3: If the Range Concept is adopted: What is the MAM

If CUP method is used only single year (current year) data is to be used. If RPM/CPM/TNMM methods are used then the weighted average of the comparables arrived for the three year period would be used.

Step 4: Arrange the data entries in ascending order

Step 5: Range is determined using the 35th and 65th Percentile

The rules have specifically mentioned parameters for the construction of the range that can be understood from the following matrix-

Number of Values in the Data Set	35th Percentile	65th Percentile
6	2.1 = 3rd Value	3.90 = 4th Value
7	2.45 = 3rd Value	4.55 = 5th Value
8	2.80 = 3rd Value	5.20 = 6th Value
9	3.15 = 4th Value	5.85 = 6th Value
10	3.50 = 4th Value	6.50 = 7th Value
11	3.85 = 4th Value	7.15 = 8th Value
12	4.20 = 5th Value	7.80 = 8th Value
13	4.55 = 5th Value	8.45 = 9th Value
14	4.90 = 5th Value	9.10 = 10th Value
15	5.25 = 6th Value	9.75 = 10th Value
16	5.60 = 6th Value	10.40 = 11th Value
17	5.95 = 6th Value	11.05 = 12th Value
18	6.30 = 7th Value	11.70 = 12th Value
19	6.65 = 7th Value	12.35 = 13th Value
20	7.00 = Average of 6th & 7th Value	13.00 = Average of 13th & 14th Value

Broadly it is to be noted that (a) if the percentile arrived at is not a whole number, then the next (higher) data place would be the percentile / range point; (b) if the percentile arrived is a whole number, then the average of the number and next (higher) data place would be the percentile / range point.

Step 6: Determination of arm's length nature of the transaction

If the transaction price of the international transaction / SDT is within this range, then no adjustment is required. However, if the transaction price is outside this range, find the median of the dataset. If the percentile arrived at is not a whole number, then the next higher data place would be its median.

3.12 Apprehensions for adoption of the Range Concept

Even as the range parameters were broadened from the draft rules along with the crisp illustrations provided in the rules itself, however, such a manner of computation would benefit companies where the number of companies are 6 or more only. There are various industries / transactions where getting more number of comparable companies are difficult such as medical devices, oil & gas, contract manufacturing etc. Accordingly, the range would not benefit such industries. Further, there is little guidance as so whether the range would be an acceptable parameter while negotiations are taking place for Advance Pricing Agreements. The principal issue that was present even before the introduction of the range and multiple year data is – the availability of the data at the time of audit. This is an issue that would still persist and as such may also lead to scenarios where the number of companies may change from 6 or more to less than 6 thereby changing the approach from a range concept to the arithmetic mean. This would most definitely cause considerable hardships if comparables are not analysed appropriately and at the right time.

4. Conclusion

The introduction of range concept is expected to significantly impact Transfer Pricing litigations and assessments. However, in spite of introducing the range concept in India Transfer Pricing regime, it is not in sync with globally accepted norms and practices (which mostly is in the range of 25th - 75th percentile). It is important to note that with the mechanism proposed by the CBDT for calculating the allowable range, in cases where comparable companies comprises lower / mediocre level of margins, the present mechanism of using arithmetic mean along with the allowable deviation of +/- 3% would be beneficial for the taxpayers rather than the use of range mechanism as notified by the CBDT. The range concept appears to be beneficial in cases where comparables set comprises many super profit companies along with mediocre margin companies. Therefore, it becomes important to note that count of comparables equally matters along with the value of margins. With all the above welcome positive changes there are certain points which create uncertainty to taxpayer in computation of ALP for their international transactions or specified domestic transactions such as the use of the prescribed range coupled with the fact that at the time of transfer pricing assessment, on account of the current year data availability, companies can be added / removed from the comparable set. This will certainly lead to ambiguous situations for a taxpayer for preparing transfer pricing study report in the current year and its evaluation after two years during the assessment proceedings. Further, the amendments are with effect from 2014-15 onwards and as such the transfer pricing studies conducted for FY 2014-15 may need to be revisited in light of the notified final rules.

CA. Karishma Phatarphekar & Shefali Shah, MBA

Functional, Comparability and Economic Analysis

In the Transfer Pricing etymology, the term functional analysis means an overview of the key economic functions performed by an entity, the assets used and risks borne by each entity. The Act lays down that transaction between two associated enterprises (AEs) should be computed having regard to the arms' length price (ALP). Each business is peculiar in its style of functioning and thereby the combination of functions, assets and risks (FAR) may differ. It is important to study the FAR as it is the foundation pillar which plays a pivotal role in determining the ALP.

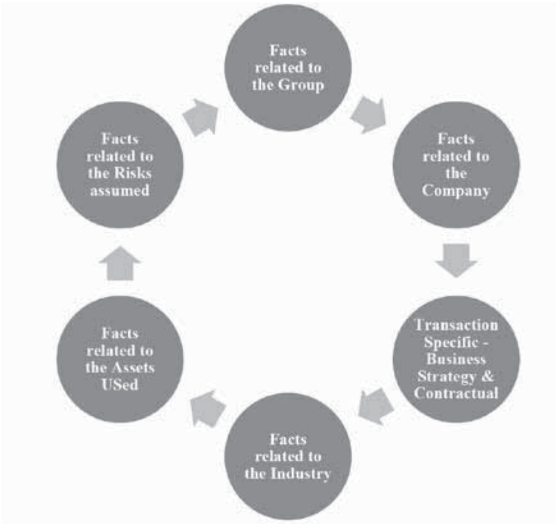
The Supreme Court in the case of ***Morgan Stanley and Company Inc. [292 ITR 416]*** emphasised on the importance of the FAR analysis for the purpose of undertaking benchmarking analysis to determine the arm's length price of the international transaction. Further, importance of FAR is emphasized in various Tribunal judgments which include ***Maersk Global Centres (India) (P.) Ltd. v. ACIT [2014] 147 ITD 83 (Mumbai - Trib.) (SB); Mentor Graphics (Noida) (P) Ltd. vs. DCIT [109 ITD 101]; E-Gain Communication (P) Ltd. vs. ITO [118 TTJ 354]; Hoganas India (P.) Ltd. vs. Dy. CIT [2013, 30 taxman.com, 390] etc.*** wherein the Hon'ble Benches have ruled that FAR is critical for conducting the economic analysis. FAR of the tested party should be kept in mind while selecting the comparable companies. The comparable companies selected should have similar FAR, in case of any differences, suitable adjustments should be made as per Income Tax Rules 10-B(1)(e)(iii) and 10-B(3) of the Income Tax Rules, 1962.

A. Purpose of FAR

Rule 10B of the Income Tax Rules, 1961 require a functional analysis to determine whether controlled and uncontrolled transactions are comparable or not. The purpose of conducting a detailed FAR analysis is to provide an in-depth understanding of the business. In-depth understanding can be gathered by organising facts about the role of each entity in the value chain of the group. It is important to identify the critical functions which add economic value to the transaction to determine the reward one should get. This reward is determined by identifying the tested party, selecting the most appropriate method and then comparing the controlled transaction with an uncontrolled transaction and make any economic adjustments, if required.

B. Information gathered during FAR analysis

The typical information gathered in a FAR analysis include:



1. **Facts related to the Group:** As a first step in FAR analysis, it is quintessential to understand the business group as a whole. One needs to broadly understand the group ownership structure, the business verticals the group caters to, the products the group deals into, how is the group's financial performance, etc. This gives a broad idea and acts as a good starting point to understand the facts of the Company better.

2. **Facts related to the Company:** Once data regarding the group is gathered, one needs to gather data related to the Company. This would include information regarding the background and history of the company, its business operations and activities, the management and organization structure, products, markets etc.

3. **Facts related to the transaction** (Contractual arrangements and Business Strategies): This data is specific to the transaction. It is important to understand the nature of transaction, role of each entity in the transaction, the economic significant function performed by each entity, the value drivers and the contractual arrangements vis-à-vis actual functions performed.

The functions that may need to be considered may include research and development, product design and engineering, manufacturing, extraction and assembly, purchasing and materials management, marketing and distribution, sales, logistics, legal, accounting and finance, collection, human resources etc.

Contractual Terms: Significant contractual terms should also be understood. These would include the form of consideration charged or paid; the volume of transactions, warranties, guarantees, any type of rights conferred by one party onto another, duration of the contract, termination or renegotiation rights; pricing and credit terms any other important terms and conditions in the contract. These contractual terms are essential to understand to identify accurate comparable and to make adjustments for differences, if any. For e.g. if the pricing term as per contract is CIF, i.e., cost plus insurance and freight. However in case of comparable, the pricing is FOB i.e., free on board then adjustment to the price will have to be made to the tested party to the extent of insurance and freight to arrive at a like to like price for the purposes of determining the ALP.

Business Strategy: When a company has a peculiar business strategy or business rationale (like market penetration strategy, market segment, business portfolio approach etc.) for undertaking a particular transaction, it is important to understand the same and document it (like agreements, common group policy, written pricing policies, market strategy, pricing strategy, competition strategy etc.)

Companies follow various business strategies relating to new product launches, research and development, innovations, market penetration or expansion of market share to increase the top line or bottom line. Sometimes such strategy may even reduce the profits of the company in the short run but reap benefits in the long run. Such strategies must be well documented along with implementation reasons. Also, adjustments should be made if comparable companies do not have similar business strategies. If a new product is launched, then costs related to research and development, marketing etc. may be adjusted if comparable do not have similar costs in its books.

In case of a start-up company, the management has decided to sell goods at a price lower than competition to establish a foothold in the market. In such a scenario, it is prone that the Company may incur losses. Such company cannot be compared with established companies and if compared suitable adjustment of the differential selling price may be made. Also such start-up companies should not be included while determining the ALP of an established player in the same market.

4. **Facts related to the Industry:** An industry overview is an important aspect in FAR analysis which is generally not paid attention to. Understanding an industry is important to understand how a business function is a particular way. Some industries are cyclical in nature (like agriculture), some industries have longer gestation period (like mining, oil drilling), some industries are regulated by government regulations (telecom, insurance, pharma). The market for some may be monopoly, oligopoly or monopolistic. Due to certain regulatory changes in a particular industry companies may be earning high or low profits. Thus it is critical to understand these industry factors, market forces and competition to be able to understand whether the company being analysed is affected by any industry dynamics or not.

5. **Facts related to the Assets used:** One needs to analyze the type and nature of assets used in a business. Assets could be of tangible and intangible in nature. Tangible assets could comprise of Production Equipment & Machinery, large ship vessels, buildings, office equipment's, vehicles etc. Intangible assets may be of various forms like patents, technical know-how, formulae, trademarks, brand names, licences & copyrights, technical data, customer lists etc.

Knowledge about the assets owned facilitates in understanding the respective roles played, contributions made by each entity participating in the transaction. It thereby plays a pivotal role in determination of the reward to be earned by an entity owning assets *vis-à-vis* an entity not owning assets for e.g. the return of logistic service provider owning vessels will be different from the one not owning vessels, the return that an entity owning an intangible asset like copyright, patent, know-how will be different from an entity who is just a low risk manufacturer or distributor or service provider and not owning any intangibles.

6. **Facts related to the Risks undertaken**
Another important aspect in the FAR analysis is gathering information on the various risks that are assumed by each party to the transaction. In business parlance, it is said that risk and return go hand-in-hand i.e., more the risks assumed by the entity, higher the returns expected to be earned and lower the risk, the return expectation is normally lower.

The below is an illustration of various type of risks faced by an entity:

Product / Service related risk
• Risk pertaining to design and development of product
• Upgradation / obsolescence of product
• Service liability risks (including after sales service)
• Risks associated with R&D
• Product liability risk
• Intellectual property risk
Market risk
• Development of market including advertisement and product promotion
• Fluctuation in demand, prices, inventory
• Business cycle risk
Collection risk
• Bad debt risk
Financial risk
• Method of funding
• Funding of losses
• Foreign exchange risk
• Loss on capital invested
Environment and Regulatory risk
• Change in country political environment
• Change in regulatory environment
Technology risk
• Upgradation / Obsolecense of Technology
• Risk arising out of system falure

On undertaking the risk analysis, it is important to understand which entity bears each type of risks. Sometimes, one may come across cases where the contractual terms, functions performed and risks assumed by each entity may not be aligned. Hence this step ensures companies to align the risk assumed with contractual terms and functions performed and assets utilised by each entity.

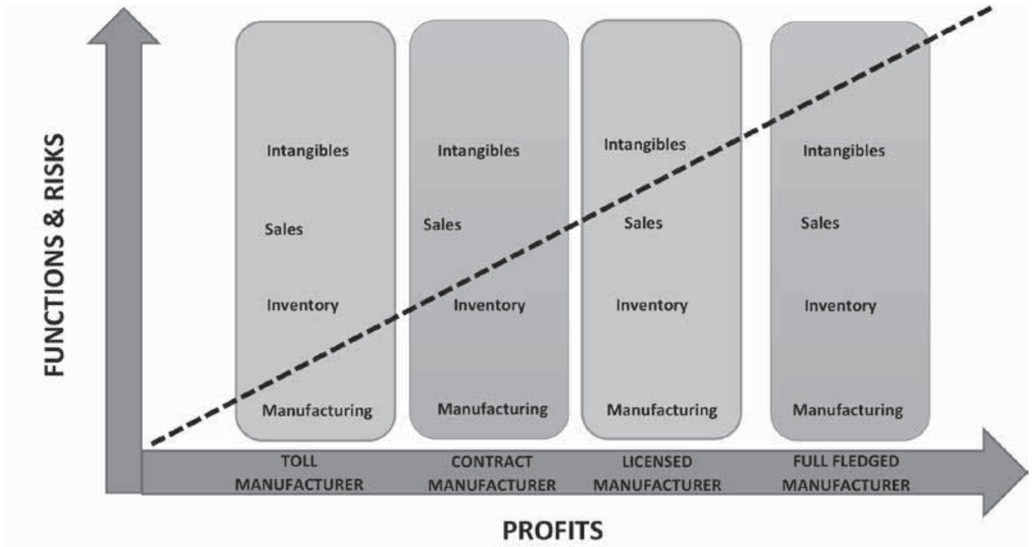
C. Entity Characterisation

Entity characterisation is one of the main objectives of the FAR analysis. Once all the above mentioned information is gathered while conducting the FAR analysis, entity characterisation is the first step towards undertaking the economic analysis.

Entity characterisation is a summary of the value drivers of the entity i.e. functions, assets and risks. This characterisation provides insight on the type of comparable that will be required to benchmark the transaction. The examples of a typical entity characterisation for a manufacturer and a distributor is explained in the ensuing paragraphs.

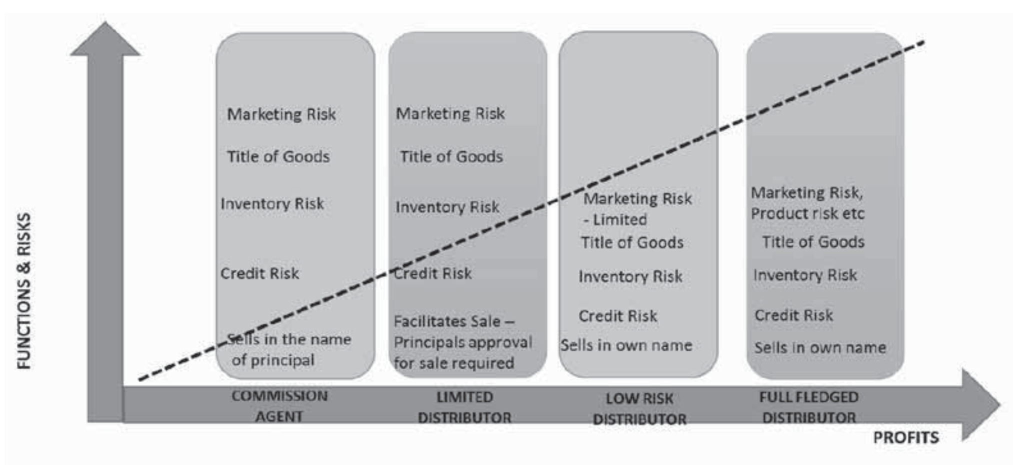
a. Manufacturer

The below diagram characterises various types of manufacturers on a scale of functions and risks *vis-à-vis* profits. A full-fledged manufacturer performs significant functions, assumes high risk and anticipates higher profits. A toll manufacturer performs the least function and assumes the lowest risk and expects a low routine return for the toll manufacturing function. The licensed and contract manufacturers fall in between the toll and full-fledged manufacturers.



b. Distributor

The below diagram characterises various types of distributors on a scale of functions and risks *vis-à-vis* profits. A full-fledged distributor performs significant functions, assumes high risk and anticipates higher profits. A commission agent performs the least function and assumes the lowest risk and expects a low routine fixed return.



D. Selection of tested party

Tested party means the entity in an international transaction with whose reference the international transaction is tested. The transfer price or profits of the tested party is compared with uncontrolled transactions. The tested party selection is based on the entity which has the least complex functions. Generally an entity performing simpler functions, does not own valuable intangibles and the entity which would require least adjustment is selected as a tested party.

Also another important aspect while selecting a tested party is the availability of financial information of comparable companies. If sufficient financial information pertaining to comparable is not in the country of the tested party then such entity cannot be selected as the tested party.

The selection of the tested party influences the selection of the most appropriate method to benchmark the transaction and select appropriate comparable.

Selection of tested party as a concept is not provided in the Indian Transfer Pricing Rules. This concept is explained in the OECD guidelines in para 3.18 and 3.19; United Nations Practical Manual on Transfer Pricing in paras 5.3.3.1, 6.2.20.3, 6.3.3.2 & 6.3.3.4; US regulations section 1.482-5.

There are also renowned decisions on the selection of tested party issues. Some of the judicial pronouncements include: ***Ranbaxy Laboratories vs. ACIT [2016] 68 taxmann.com 322 (Delhi – Trib.)***; ***GE Money Financial vs. TS-216-ITAT-2016 (DEL.), General Motors India Pvt. Ltd. vs. DCIT (2013] 27 ITR (Trib.) 373; Development Consultancy vs. DCIT - 115 TTJ 577***.

E. Selection of Most Appropriate Method and selection of PLI

Once the entity characterised and tested party is selected, the next step is to select the most appropriate method. The Indian TP regulations, prescribe 6 methods to determine comparability:

1. Comparable Uncontrolled Price (CUP),
2. Cost Plus Method (CPM),
3. Resale Price Methods (RPM),
4. Profit Split Method (PSM),
5. Transactional Net Margin Method (TNMM), and
6. Other Method

The Indian regulations do not prescribe preference for a particular method. The most appropriate method is to be selected keeping into perspective the FAR analysis and the availability of suitable comparable. Sometimes, a particular method may be best suited given the FAR analysis however if adequate comparables are not available then one needs to select the more reliable method where comparability analysis will be possible. For e.g., a company is importing researched active pharmaceutical ingredient to manufacture finished dosage formulations. Ideally CUP method would be best suited if exact API is imported by a third party. However such data may not be available in the public domain and hence it becomes difficult to apply the CUP method and hence the next best suitable method, may be TNMM is used to benchmark the said transaction. Decisions that can be referred to for such inference include: ***Serdia Pharmaceuticals (India) Pvt. Ltd. vs. ACIT [2011] 44 SOT 391 (Mumbai); UCB India P. Ltd. vs. ACIT [2009] 121 ITD 131 (Mumbai).***

Once the method is selected, it becomes imperative to select an appropriate Profit Level Indicator (PLI) to benchmark the profits or determine the ALP. Some of the generally used PLIs include:

Manufacturer / Service Provider	• Operating Profit to Total Cost
Distributor	• Operating Profit to Sales; or • Gross Profit to Operating Profit or Sales
Value Added Distributor	• Value Added Profit to Sales
Commission Agent	• Berry ratio (Gross Profit / Operating Expenses)
Capital Intensive Company	• Operating Profit to Capital Employed

Another important aspect to consider while selecting the appropriate PLI is the related party transaction. One should not select a PLI whose denominator is tainted for e.g., if the related party transaction pertains to imports, purchases or payments then PLI with cost as the denominator cannot be considered as the appropriate PLI, similarly if related party transactions pertain to exports then PLI with sales as a denominator cannot be considered as the appropriate PLI.

Selection of PLI is thus based on the FAR of the entity, availability of financial information of comparable companies and type of related party transaction.

F. Comparability Analysis

1. Two Types of Comparability analysis:

i. Internal Comparability Analysis

Internal comparable means selecting a comparable transaction between one of the parties to the controlled transaction (taxpayer or foreign associated enterprise) and an independent party.

For example: A Co is situated in US and has a subsidiary in India B Co. B Co. is providing assembling services to A Co. B Co. is also providing similar assembling services to another third party i.e., D Co. Hence transaction between B Co and D Co can be considered as an internal comparable to determine the ALP for transaction between A Co and B Co.

Another example of internal comparable would be that if A Co is receiving similar services from E Co in India then transaction between A Co and E Co can be considered as an internal comparable to determine the ALP for transaction between A Co and B Co.

In both the above examples, CUP method is selected as the most appropriate method then the price charged to assemble per product can be considered to determine the ALP or if TNMM is selected as the most appropriate method then profit earned in both segments can be compared to determine the ALP.

Internal Comparables are generally preferred as they establish direct comparability and reliable information related to establish comparability is available. However internal comparable may not always be necessarily the best comparable if there are differences e.g. in transaction volumes, contractual terms, geographical markets and business strategy which are material and cannot be eliminated through reliable comparability adjustments. In such cases external comparability is undertaken.

ii. External comparables

External comparable are third party comparable available in the public domain where the comparable transactions between two independent parties, neither of which is a party to the controlled transaction is used to determine ALP. Such data of external comparable is available on databases (like Prowess, Capitaline, Bloomberg etc.), publications, government sources, websites of Trade institutions and organisations, research reports etc.

While using external comparable data a systematic and logical search process should be followed. Reliable quantitative and qualitative analysis should be undertaken to establish comparability with the tested party. Cherry picking of data should not be resorted to. Once potential comparables have been selected, reasonably accurate comparability adjustments can be performed where necessary to enhance the reliability of the comparisons.

However, as per the Indian judicial precedents and interpretation of the rules internal comparables are preferred over external comparables. The same has been discussed in length in the Third member decision of the Mumbai Tribunal in the case of ***Tecnimont ICB (P.) Ltd. vs. Addl. CIT [2012] 138 ITD 23 (Mumbai).***

2. Factors to be considered to determine Comparability analysis

Functional Comparability is the most important while selecting comparables. The importance for the same has been explained above and also clearly established in the special bench decision in the case of ***Maersk Global Centres (India) (P.) Ltd. vs. ACIT [2014] 147 ITD 83 (Mumbai - Trib.) (SB)***. The same has also been upheld by the Delhi High Court as a principle in the case of ***Rampgreen Solutions (P.) Ltd. vs. CIT [2015] 377 ITR 533 (Delhi).***

Furthermore, while selecting the final comparable to determine the ALP apart from FAR there are other comparability parameters that need to be evaluated. Some of these parameters include

i. Financial data

Companies having data for same financial year should be considered. In case the financial data is of a different financial year as compared to the tested party then such company cannot be selected as comparable since different accounting years may have multitude factors (like difference in input costs, market dynamics, competition etc.) which would affect the margin. This has been recently upheld by the Bombay High Court in the case of ***CIT vs. PTC Software (I) Pvt. Ltd. (ITA No. 732 of 2014, Bom HC).*** However, Delhi High court in the case of ***CIT vs. McKinsey Knowledge Centre India Pvt. Ltd. (TS-672-HC-2015 (Del) – TP) (ITA 217 of 2014, Del HC)*** has ruled contrary to the recently pronounced Bombay High Court decision. It states that, if the comparable is functionally comparable to the assessee and the financial data can be reasonably extrapolated then company cannot be eliminated on the ground of following a different financial year end.

Also companies may follow different accounting standards while reporting the financials. One should select companies having same accounting standards as that of the tested party, otherwise reasonable adjustments should be made to ensure accounting consistency with the tested party.

ii. Aggregation vis-à-vis segregation

Another important aspect of comparability is whether transactions should be benchmarked at an aggregated level i.e. entity level or should they be segregated into various segment.

Transactions that are closely linked to each other and cannot be separated should be aggregated at entity level for e.g. a distributor selling a basket of products should be tested at entity level since it is impossible to segregate the products and ascertain the return earned from a particular product. The distributor business strategy would be make higher profits on some products and lower profits on the others but overall earn a commensurate margin.

In cases whether the transactions are separate and not inter-linked with each other and reliable comparable data is available then the transactions should be segregated and analysed at segment level. In such scenario segmented data provide better comparable than company-wide, non-segmented data, because of a more transactional focus.

Hence the decision to aggregate or segregate transactions for benchmarking purposes should be done based on the business circumstances and availability of comparable. The latest decision pronounced by High Court on this issue was in the case of ***Knorr-Bremse India (P.) Ltd. vs. ACIT [2016] 380 ITR 307 (Punjab & Haryana).***

iii. Geographic location

Geographic location for controlled and uncontrolled transaction is required to be similar since the economic environment plays a significant role in determining the input cost as well as the final selling price. The same has been held in the case of

iv. Reliability / Completeness / Availability of the data in the public domain

The external comparable data should be available in the public domain. Further, the external data used should be reliable and complete. If any data is obtained from unreliable source or is incomplete will lead to unreliable comparability analysis. The same has been held in the case of

v. Level of the market

A margin of a wholesaler cannot be compared with a retailer since the level of market is different. Hence level of market is an important factor to be considered while determining comparability.

vi. Scale of operations

Comparable must be selected such that their financial performance reasonably reflects the scale of economies of the controlled party for example size criteria in terms of Sales, Assets or Number of Employees should be considered while selecting comparable. The same has been upheld by Delhi High Court in the case of ***Rampgreen Solutions (P.) Ltd. vs. CIT [2015] 377 ITR 533 (Delhi)*** and by Bombay High Court in the case of ***CIT vs. Pentair Water India (P.) Ltd.[2016] 381 ITR 216 (Bombay).***

vii. Related party transactions

Only uncontrolled transactions can be used as comparable. However, this may pose an impediment on finding adequate number of comparables. Therefore in a few cases this filter is relaxed to accepting comparables which have up to 10% related party transactions and in a few cases they are permitted up to 25% limit. There are number of decisions on this issue and a few of them worth referring include: Willis ***Processing Services (I) (P.) Ltd. vs. DCIT [2014] 30 ITR (T) 39 (Mumbai - Trib.); Actis Advisers Pvt. Ltd. vs. DCIT (ITA No. 5277/Del/2011); CIT vs. PTC Software (I) Pvt. Ltd. (ITA No. 732 of 2014, Bom HC).***

3. Adjustments to comparables

As mentioned earlier, while conducting the comparability analysis, if there are certain differences between the FAR or financial data between the tested party and the comparable then reasonable accurate adjustments should be made for determining the ALP.

Where CUP is considered as the most appropriate method, it requires a high degree of comparability between the controlled and uncontrolled transactions. This standard of comparability is ordinarily extremely difficult to meet. Accordingly, the CUP method can be used to determine a reliable arm's length price only if close comparability is possible or else reasonable accurate adjustments should be done to adjust for the possible differences. The various types of adjustments that can be undertaken are as follows:

i. The type and quality of the products

For e.g. if A Co is selling packaged finished good to third party customers whereas selling unpackaged finished goods to its AE then the packaging cost will be adjusted to arrive at a like to like price comparison between AE and third party

ii. Delivery terms

For e.g. if A Co is selling packaged finished goods to third party customers at CIF price whereas selling similar product to its AE on FOB terms then the freight and insurance will be adjusted to arrive at a like to like price comparison between AE and third party

iii. Volume of sales and related discounts

If a company is providing certain volume discounts or cash discounts to AE and not to third party then the adjustment should be made to analyse the impact of the same.

iv. Product characteristics

If A Co is selling cars to third party customers with air bags whereas selling same cars without air bags to its AE then the price difference pertaining to air bags should be adjusted to arrive at a like to like price comparison between AE and third party

The above are few examples where accurate adjustments are possible and made to arrive at a like-to-like comparability with the tested party. In some cases reasonably accurate adjustment may not be possible like transactions which involve unique and valuable trademarks, where there is a fundamental difference in the products in such cases, comparability under CUP method would be not be possible and one may need to consider other methods like TNMM for comparability purposes.

Under TNMM, apart from the above adjustments, working capital adjustment and risk adjustment can also be undertaken:

v. Working Capital adjustment

It is very common for the tested party and each of the comparables to differ in the amount of working capital. Such differences are generally caused by differences in the financing terms of purchase and sale that the company receives from its suppliers and extends to its customers, and by differences in the levels of inventories held by the company. In order to reduce the effect of differences the receivable, payables, and inventory balances are adjusted. Working capital adjustment upheld by the Delhi Bench of the Tribunal in ***Sony India (P) Ltd. (ITA No. 1189/Del/2005)], Philips Software Center Private Limited (2008-TIOL-471-ITAT-BANG); Philips Software Center Private Limited (2008-TIOL-471-ITAT-BANG); Capgemini India P. Ltd. vs. Assistant Commissioner of Income tax (2013)27ITR (Trib) 74 Mum.; Mercer Consulting (India) (P) Ltd. vs. Dy CIT (2014) 108DTR (Trib.) 348 Del.; Demag Cranes & Components (India) P Ltd. vs. DCIT (2013) 24 ITR (T) 760 (Pune) etc.***

vi. Risk adjustment

Different entities may be assuming different types of risks. Captive units by definition operate in a virtually 'risk-free environment' while entrepreneurial enterprises undertake the full range of economic risks e.g. market risk, price risk, product risk, idle-time risk, credit risk, foreign exchange fluctuation risk, technology obsolescence risk, warranty risk etc. With economics governing the commercial world, margins earned are a result of three interplaying variables, viz. functions performed, assets utilised and risks borne. Most importantly higher the risks undertaken higher are the expectations of rewards. An appropriate risk adjustment therefore needs to be warranted to the margins earned by the comparable companies to make an equitable comparison. Various judicial pronouncement like ***Philips Software Center Private Limited (2008-TIOL-471-ITAT-BANG); Mentor Graphics Noida Pvt. Ltd., vs. DCIT (2007-TIOL-382-ITAT-DEL); Motorola Solutions India Pvt. Ltd. vs. ACIT (ITA No 5637/Del/2011); Watson Pharma (P.) Ltd. vs. DCIT [2015] 38 ITR (T) 97 (Mumbai - Trib.)*** etc. have held that risk adjustment should carried out to adjust the risk differences between the tested party and the comparable companies.

G. Convergence of BEPS Actions plans with the Indian Transfer Pricing Practice

While conducting the FAR, it may sometimes be apparent that one company performs one particular function but the cost is borne or benefit is accrued to another party of the group.

In such situation, it is important to consider that the party which undertakes particular functions should bear the related risk and reward. Mere legal ownership should not enable an entity to accrue all the benefit related to functions and risks undertaken by another entity. This has been a consistent stand taken by the Indian transfer pricing authorities.

The ***OECD Action Plan 8-10*** on Base Erosion and Profit Shifting (BEPS) details rules to prevent BEPS by transferring risks among, or allocating excessive capital to group members. This will mean that inappropriate returns do not accrue to an entity solely because it has contractually assumed risks or has provided capital. Return earned by an entity would be commensurate of the functions performed, assets used and risk assumed. Mere contractual obligation or legal ownership would not enable an entity to earn extra ordinary returns.

The Action plans lays down that an entity which controls/performs the development, enhancement, maintenance, protection and exploitation (DEMPE) functions in relation to the intangibles should be entitled to the related returns. An entity controlling risks, assuming funding responsibility and not having the financial capacity to assume risks or fund the intangible in association with the DEMPE of the intangibles is not entitled to earn extra ordinary returns.

Legal ownership alone does not necessarily generate a right to all of the return generated by the intangibles' exploitation. The provision of funding alone without control of the underlying risks does not entitle the funder to anything above a risk-free return

The Action Plans clearly state that the functions, risks, funding, assets, contractual arrangements etc. will have an interplaying role in determining whether the return earned by an entity will be routine or the entity can earn extra-ordinary return commensurate to the functions and risks assumed.

The CBDT had issued a ***Circular No.06/2013 [F NO. 500/139/2012], dated 29-6-2013*** which exactly addressed this issue. The Research and Development Centres set up by foreign companies were classified as contract R&D service providers with insignificant risk while the Transfer Pricing Officers (TPO) treated them as full or significant risk-bearing entities.

The circular clearly defined the functions performed, assets used and risk borne by Centres which are entrepreneurial in nature; Centres which are based on cost-sharing arrangements; and Centres which undertake contract research and development.

For Centres to be classified as Contract R&D, the foreign principal should actually perform and control economically significant functions and bear and control risks and costs relating to R&D. Companies will have to maintain documentation to prove this to the authorities. Only then such Centres would earn routine profits.

Further, the Action Plan has also simplified the approach to deal with low value-adding intra-group services "LVIGS". Activities that are classified as LVIGS in the Action Plan include Accounting and Auditing, Processing and management of account receivable and account payable, Human resource related activities, Monitoring and compilation of data relating to – health, safety, and environment, Information technology support services, Internal and External communication and Public Support services, Legal services / activities relating to tax obligations / general services of administrative or clerical nature.

Further activities that will not be considered as LVIGs would include Services relating to the core business of the Group, R&D, manufacturing and production services, Sales, marketing and distribution activities, Financial transactions, Insurance and reinsurance, Extraction, exploration or processing of natural resources, Services of corporate senior management.

The Action plan states for an activity to be considered as LVIG, once must prove the need for such service, the benefits received, services have actually been received, services received are not duplicative and whether a third party would be actually willing to pay for such service.

In India, the tax authorities have always analysed these factors i.e., need for services, benefit test, proof that services have actually been received, and whether a third party would be willing to pay for such services. Various judicial pronouncements have discussed these aspects in length which include ***M/s. Cushman & Wakefield India Private Limited ([2014] 46 taxmann.com 317, Delhi HC), GE Money Financial Services (P.) Ltd. vs. Asstt. CIT [2016] 69 taxmann.com 420 (Delhi - Trib.); CIT, LTU vs. Fosroc Chemicals India (P.) Ltd. [2016] 69 taxmann.com 43/240 Taxman 731 (Kar.) Knorr-Bremse India (P.) Ltd. vs. Asstt. CIT [2016] 380 ITR 307/[2015] 236 Taxman 318/63 taxmann.com 186 (Punj. & Har.) etc***.

Thus it may be right to say that the Action plan 8-10 is not something new for the Indian companies. The Indian TP administration were always advanced to this line of thought. It is now that the BEPS Action Plan has converged with the Indian transfer pricing administration and practice, which is being followed since over a decade now.

H. Conclusion

In today's global environment, companies are functioning cross borders and the functions, risks and assets are often shared between entities in across jurisdictions. As mentioned above, a detailed FAR analysis will enable one to chart the economic significant functions carried out by each entity *vis-à-vis* the assets used, risks assumed and contractual obligations. It is important to establish the value drivers and economic substance of the transaction to determine appropriate reward for each entity in a multinational group. In the world of tax transparency this analysis is becoming fundamental and increasingly important to defend transfer pricing policies of global multinationals.


CA Jiger Saiya & CA Abhay Kumar

Transfer Pricing Issues and Controversies

Globally, India is considered as the most litigated tax jurisdiction in so far as it relates to Transfer Pricing (TP) disputes. Since its introduction in 2001, controversies and litigation surrounding TP have evolved. During initial round of TP assessments, most disputes centered around basic and procedural issues, viz., selection / rejection of comparable, use of multiple year data, treatment of an item of income or expenses as operating or non-operating in nature, etc. However, with growing maturity and experience of tax administrators and taxpayers, there has been a perceptible shift in the nature of TP disputes in India. The TP disputes and issues raised by the Transfer Pricing Officers (TPOs) are now more complex and nuanced, e.g. marketing intangibles, location savings, intra-group services, etc. This article deals with some of the key TP disputes that have hogged limelight in the Indian transfer pricing landscape in recent times.

A. Advertisement, Marketing and Promotion (AMP) expenses by Indian licensees

Background

Indian affiliates (hereinafter referred as "Indian taxpayers") of foreign Multinational Enterprises (MNEs) selling branded products, under licence from their overseas associated entity (AE), have been facing transfer pricing additions in respect of advertisement, marketing and promotion (AMP) expenses. The TPOs allege that incurring excessive AMP expenses by the Indian taxpayers is an international transaction. Applying the Bright Line test (BLT), AMP expenses incurred by the Indian taxpayers (AMP expenses as a percentage of Sales) are compared to that of comparable companies. Excess is alleged to indicate provision of services in the nature of enhancing / creating the value of brand legally owned by the AE. TPOs have been making TP adjustments by imputing income in the hands of Indian taxpayers on the premise that the Indian taxpayers, licensed manufacturers and distributors alike, should recover such excess AMP expenses incurred (alleged as non-routine AMP expense) from its AE along with a suitable mark-up. Indian taxpayers have been contesting such AMP related TP adjustments on following substantive grounds:

- Incurring of non-routine AMP expenses is on its own volition and for own benefit, therefore not an "International transaction";
- BLT is not a method specified under Indian TP regulations;
- There is no need for separately benchmarking the AMP expenses as the

same is subsumed in the taxpayers' overall profit margin;

- Selling expenses and expenses in connection with sales, like travelling and commission/incentive paid to dealers or agents, are not part of AMP expenses qualifying for brand promotion

Indian transfer pricing jurisprudence on AMP

Special Bench Ruling in the case of LG Electronics India[1]

Considering the importance and complexity of the issue, three-member Special Bench was constituted by the Income Tax Appellate Tribunal (ITAT) in the case of L. G. Electronics India to adjudicate on the subject of AMP expenses. Several other Indian taxpayers[2], affected by the AMP issue, also appealed together with LG Electronics India as interveners. The broad principles emanating from the Special Bench decision were:

- Incurring non-routine AMP expenses qualified as International transaction;
- International transactions may not necessarily be expressed in black and white but may be inferred from the conduct of the parties;
- Upheld the application of BLT;
- Arm's length value of non-routine AMP expenses needs to be computed separately and cannot be subsumed under entity level TNMM analysis;
- Selling expenses which do not lead to brand promotions should be kept out of the realm of AMP;
- No set-off or adjustment can be allowed in respect of one international transactions against other international transactions.

Subsequent to the Special Bench ruling, most of the AMP related cases pending before various benches of ITAT got remitted to the file of the TPO with specific direction to follow the principles laid down by the Special Bench in the L. G. Electronics. This resulted in significant TP adjustment in several cases.

Delhi High Court ruling in the case of Sony Ericsson[3] & Maruti Suzuki India[4]

Aggrieved by the order of the ITAT which followed Special Bench decision in the case of L. G. Electronics India, several taxpayers, mostly consumer electronics and consumer durables giants like Daikin, Haier, Reebok, Canon and Sony, appealed before the Delhi High Court (HC). While pronouncing its decision, the HC laid out following broad principles:

- Incurring AMP expenses may be treated as International transaction;
- BLT approach followed by the TPOs is not permissible under the Indian TP regulations and hence rejected;
- Distribution function and marketing functions are intertwined functions and arm's length price (ALP) should be determined in a bundled manner;
- If the bundled approach is found appropriate, in cases where the gross margin or net margin of the Indian taxpayers are sufficient to cover the excess AMP expenses, no separate remuneration for such excess is required;
- If the distribution and marketing functions are to be de-bundled then the taxpayer should be allowed to set-off additional remuneration in one function with a shortfall in other function;

1. L. G. Electronics India Private Limited vs. Asstt. Commissioner of Income Tax (ITA No. 5140/Del/2011)
2. Haier Telecom Pvt. Ltd; Goodyear India; Glaxo SmithKline Consumer India; Maruti Suzuki India; Sony India; Bausch & Lomb; Fujifilm Corporation; Canon India; Diakin India; Amadeus India; Star India; Pepsi Foods India
3. Sony Ericsson Mobile Communication India Pvt. Ltd vs. Commissioner of Income Tax (ITA No. 16/2014)
4. Maruti Suzuki India Limited vs. CIT (ITA No. 110/2014 & ITA No. 710/2015)

Although the Delhi HC laid down broad principles and guidelines for computing ALP of distribution and AMP function in case of distributors of branded goods, the confusion on applicability of the HC ruling for licensed manufacturer still persisted.

The TP issues in respect of AMP expenses for a licensed manufacturer were adjudicated by the Delhi HC in the case of Maruti Suzuki India Limited (MSIL). The central issues requiring adjudication in this case was whether the incurring AMP expenses by MSIL was an "international transaction". The HC in this case, held that incurrence of AMP expenditure cannot be considered as International transaction. The HC based on its decision in the case of Sony Ericsson rejected the BLT, the very basis of determining the existence of international transaction. Further the HC also reasoned that there was no agreement and or arrangement, express or implied, between MSIL and its AE obliging MSIL to incur AMP expenses. The HC also reconciled the decision in the case of Sony Ericsson with that of MSIL case, in so far as it related to existence of International transaction on account of AMP. The HC highlighted the fact that appeal of MSIL was delinked from the Sony case to be heard separately. It further highlighted the fact that other appellants in the Sony Ericsson case never questioned the existence of International transaction of AMP expenses.

A combined reading of both the above rulings of Delhi HC suggest that incurring AMP expenses by Indian taxpayers, distributor or manufacturer alike, by itself does not qualify as international transaction. Revenue would need to establish that the Indian taxpayer was under an obligation, express or implied, to incur AMP expenses on account of the AE and that AMP expenses have, in fact, increased the value of brand owned by the AE. Further, wherever AMP is characterised as International transaction, bundled approach, as suggested by HC in Sony Ericsson case and affirmed in the case of Maruti Suzuki, may be followed in appropriate cases to justify the arm's length characteristic of AMP expenses.

Not the end of AMP saga

The last chapter of the AMP saga is yet to be written. Some of the aggrieved Indian taxpayers, viz., Sony Ericsson, Canon India and Daikin India have filed a special leave petition (SLP) before the Supreme Court (SC) challenging the Delhi HC ruling. It is learnt that these taxpayers have filed the SLP mainly on the ground that the incurring AMP expenses by the Indian taxpayers cannot be considered as International transaction. Further, the SC has also admitted Revenues SLP against the Delhi HC ruling in the case of Honda Siel , where the TP adjustment was deleted following the Delhi HC ruling in the case MSIL.

B. Intra-Group Services

Background

The term 'intra-group services' (also known as 'management fee' or 'management re-charges') refer to services rendered by one entity of a MNE to one or more group entities. Where such services are cross-border, they fall within the purview of Chapter X of the Income Tax Act, triggering TP implications. MNEs often have shared service centers/ common central teams who render services like accounting, legal, finance, IT support, etc. to the entire group. This gives rise to synergies and cost savings to the MNE. Allegedly, over time, intra-group services have become a popular tax planning tool/ cash repatriation strategy. This has led to enhanced scrutiny of such transactions by the Revenue, leading to ubiquitous adjustments made in cases of intra-group services.

Indian transfer pricing jurisprudence on Management Fees

The litigation around intra-group services has become a highlight over the last few years, beginning with rulings in the cases of Dresser

5. Honda Siel Power Products Limited vs.DCIT - ITA No. 346/2015

Rand[6] and Gemplus[7]. In the case of Dresser Rand, the Mumbai Bench of ITAT held that the TPO had no authority to question the taxpayer's commercial wisdom or decide what was necessary, in order to conduct business effectively. Further, it was held that when evaluating the ALP of a service, it is wholly irrelevant as to whether the taxpayer benefits from it or not. The real question which is to be determined in such cases is, whether the price of this service is what an independent enterprise would have paid. In the case of Gemplus, the Bangalore Bench of ITAT upheld the disallowance of the payment for such services, since the taxpayer was unable to produce documentation to demonstrate the nature of services and benefits derived from the same.

Another decision worth noting is the case of Cushman and Wakefield[8]. In this case the Delhi HC examined the interplay of TP Regulations with Section 37 of the Act. The HC held that the authority of the TPO is to conduct a TP analysis to determine the ALP and not to determine whether there is a service or not from which the taxpayer benefits - that aspect of the exercise is left to the Assessing Officer (AO). Further, in the case of Knorr Bremse[9] the Punjab & Haryana HC observed that the answer to the issue whether a transaction is at ALP or not is not dependent on whether the transaction results in an increase in the taxpayer's profit. The HC also held intra-group services availed can be aggregated with the taxpayer's other transactions of manufacture / sale, if the taxpayer can prove that they were all provided under one composite agreement which constitutes an International transaction.

Documentation is the key

It is essential to note that all decisions pertaining to intra-group services are completely fact specific. The outcome in such cases largely depends on the taxpayer's ability to factually demonstrate the actual availment of services and benefits derived with supporting documentary evidence and produce robust benchmarking to support the pricing of such transactions. The taxpayers should compile the necessary documents, e.g., inter-company agreements, global TP policy, evidences in respect of availing intra-group services, scientific basis of cost allocations, authenticated working of cost recharge etc. on a contemporaneous basis.

C. Location Savings

Background

Location Savings refers to the net reduction in costs by moving functions or activities from a high-cost jurisdiction to a low-cost jurisdiction. The cost reduction is on account of lower cost of labour, capital and intermediate goods/services and likely tax advantages. However, change of jurisdiction could also result in detriments like poor infrastructure/power supply, higher costs for transportation, quality control etc. Accordingly, location savings would arise if the net effect of relocation is beneficial to the business. The Indian TP Regulations do not contain any specific provisions dealing with location savings. However, this concept has found mention in the OECD TP Guidelines[10] as well as the UN TP Manual[11].

Location Savings is part of the wider concept of Location Specific Advantages (LSAs) which cover other benefits offered by a location, such as highly specialised local knowledge and personnel, proximity to growing local market, large customer base, advanced infrastructure, market premium, etc. When LSAs are available to all businesses operating in a particular location, the same may not give incremental profits, known as location rent, to any particular taxpayer.

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6. Dresser Rand India Pvt Ltd vs. Addl CIT - ITA No. 8753/MUM/ 2010
7. Gemplus India P. Ltd. vs. ACIT - ITA No. 352/BANG/2009
8. CIT vs. Cushman and Wakefield India Pvt Ltd IT No. 475/2012
9. Knorr-Bremse India Pvt Ltd vs. ACIT IT Nos. 172 & 182 of 2013 (O & M)
10. OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
11. United Nations Practice Manual on Transfer Pricing for Developing Countries

Indian transfer pricing jurisprudence on Location Savings

During the course of assessments, the TPOs have sought to make TP adjustments by applying concept of location savings in cases of MNEs having a captive contract manufacturing entity in India. Litigation around location savings became conspicuous with the Gap India[12] ruling, wherein the Delhi bench of ITAT deleted the TP adjustment on account of location savings. The ITAT held that in a developing economy, location savings arise to the industry as a whole and accordingly it cannot be assumed that the taxpayer was the sole beneficiary. The ITAT also observed that the advantage of location savings is passed on to the end customer via a competitive sales strategy. The arm's length principle requires benchmarking to be done with comparables in the jurisdiction of the tested party and the location savings, if any, would be reflected in the profitability earned by comparables which are used for benchmarking the international transactions. Accordingly, no separate/additional allocation is required for location savings. The Gap India ruling was followed by the Mumbai Tribunal in the case of Watson Pharma[13], wherein TP adjustment for location savings was once again rejected. Key takeaways from this ruling are as under:

- When a taxpayer operated in a perfectly competitive market with no access to exclusive factors giving rise to LSAs, it did not have any unique advantage over competitors;
- Adjustment for location savings should not be required where reliable local market comparables are available to identify ALP;
- Location savings are not intangibles, unless any specific advantages are capable of being owned or controlled by an individual enterprise (similar to that discussed in BEPS Action Plan 8).

TP adjustment for location savings was also rejected by the Delhi High Court in the case of Li & Fung[14] since tax authorities were unable to demonstrate the extent to which the taxpayer or its AE enjoyed locational advantages.

Does Location Savings need to be compensated

Based on the above jurisprudence, it is apparent that the applicability of Location Savings to a business structure can be identified broadly on the basis of factors such as the margin earned by comparable full risk entrepreneur companies in the same jurisdiction, competitive pricing of products /services as compared to businesses with localised structures, presence of intangibles, etc.

Jurisprudence around location savings is currently very limited. All Tribunal and court decisions so far have rejected TP adjustments made on account of location savings. This is mainly due to the inherent subjectivity in the concept and lack of guidance in the Indian TP Regulations. However, location savings has found mentioned in BEPS Action Plans 8–10 and going forward, the same is likely to bring more clarity on the concept and there is also likelihood of incorporation in the Indian TP Regulations.

D. Intangibles/Royalty

Background

Royalty is the consideration for the use or right to use any Intangible property, such as the right to use industrial know-how, patents, trademarks, trade names, designs or models. Intangibles are something that are not physical or financial asset but are capable of being owned and controlled for its use in commercial activities, whose use would usually be rewarded if such transaction transpired between independent enterprises. The fundamental nature of royalty is that the legal owner of the Intangibles continues to hold the Intangibles and permits only the use or right to use such Intangibles. Royalty payments and use of Intangibles have been a significant transfer pricing topic for discussion in India and across the globe.

12. GAP International Sourcing India P Ltd vs. ACIT IT NOS. 5147 (DELHI)/2011 &228 (DELHI)/2012
13. Watson Pharma Pvt Ltd vs. DCIT IT Nos. 1423 & 1565 (Mum.)/ 2014
14. Li and Fung India Pvt. Ltd vs. ADIT IT No. 306/2012

Transfer pricing challenges in respect of Intangibles/royalty

The issues concerning royalty are manifold. One of the pivotal areas of concern is the determination of arm's length price when valuation of the Intangibles is highly uncertain at the time of entering into a transaction. Intangibles have a specific feature of complicating the search for comparables i.e. Comparable Uncontrolled Price (CUP) is not easily available. Further, it is difficult to establish the value of the Intangibles at the time of undertaking a transaction. Thus, arriving at the rate of royalty based on the value of the Intangible becomes a challenge. The key to the issue is identifying what independent enterprises would have done in analogous circumstances. Another way of looking at the concern could be estimation of anticipated benefit that might flow in future from the use of the Intangibles and accordingly setting the rate of royalty. Sometimes, it may happen that pricing of the Intangible based only on anticipated benefits may not provide adequate protection against the risk imposed by high level of uncertainty in valuing the Intangible. In such cases it may be prudent to enter into a payment structure that involves periodic payments to safeguard against the subsequent developments that may not be sufficiently predictable or foreseeable at the time of entering into the transaction. Notwithstanding the above, the rate of royalty predetermined by the taxpayer is bound to face opposition of the revenue authorities since it may get burdensome for them to ratify what developments were foreseeable at the time the transaction was entered into. Another dilemma that may emanate before the Revenue is when there is a significant difference between the ex-ante and ex-post value of the Intangible, this difference gives an idea about the arm's length characteristic of the ex-ante pricing agreement entered into between the associated enterprises. Simply stated, when the difference, between the rate of royalty derived based on the value of the Intangible and actual rate of royalty that turns out based on the value of Intangible depending on its actual success or failure, is significant. It is generally a challenge to convince the Revenue to consider the ex-ante pricing base used by the taxpayer as genuine.

The typical issue of choosing the most appropriate method of benchmarking the royalty transaction and the litigation around that is also another issue of transfer pricing prevalent across the globe. The inherent limitation in case of placing reliance upon external CUP method is that Intangibles by the basic definition are unique. If the Intangibles are unique, their values will be unique and thus the rate of royalty arrived based on the value of the Intangibles would be unique. Two Intangibles thus can never be compared. In real sense of the terms there can never be an external CUP available to benchmark the royalty paid. In Indian parlance, typically, the royalty transactions are benchmarked using CUP Method or Transactional Net Margin Method (TNMM). Most of the litigations in India in relation to royalty payment revolves around choosing of the correct method for benchmarking the royalty transaction.

Prepare to defend the royalty rate

It is inevitable that royalty payment transactions will be subject to significant litigation across the globe. Only solution is to be well equipped to tackle litigation. It is advisable for the taxpayer to thoroughly document the details of its ex-ante projections used to determine the value of the Intangibles. Compile satisfactory evidence to display that the significant difference between the financial projections and the actual outcome is in fact due to the extraordinary developments that could not be foreseen at the time of entering into the royalty pricing agreement.

E. Cost Contribution Arrangements

Background

Cost Contribution Agreement (CCA) is an agreement within the MNE entities to ratio the contribution and benefit of joint development, production or obtaining of tangible assets, intangible assets or services. The main purpose of entering into a CCA is to lower the costs as much as possible and to maximise the rewards. Share of each MNE to the CCA is predetermined at the outset. Ideally, the share of contribution of each MNE to the CCA is proportionate to the share of expected benefit out of the arrangement. All the MNE entities participating in the CCA are entitled to exploit the interest in the CCA as an owner rather than a licensee. One of the MNE entities shall be a legal owner whereas the others qualify as economic users. Thus, none of the MNEs shell out any royalty or other consideration to enjoy its likely share of benefits out of the arrangement. CCAs are generally entered into either to share services or to perform research & development, produce or acquire assets or rights or both. Ideally, the terms of the arrangement vis-a-vis the costs and the benefits of each participating entity should be consistent with what an independent enterprise would have agreed to in a comparable circumstance.

Transfer pricing issues in Cost Contribution Arrangements

CCAs are not largely popular in India and across MNEs primarily for the challenges they pose from TP perspective.

- **Allocation of the contributions amongst the participating entities**

Each participating entity is required to demonstrate the basis of allocation of cost and its share in the CCA. Despite the fact that contributions to be made by each entity would be based on a rationale, the determination of the cost that each entity endures, bears a degree of uncertainty. There generally is a tendency to allocate cost among the participating entities in a manner that it results into higher profits in the jurisdiction with lower taxes and lower profits in the jurisdiction with higher taxes. Revenue authorities across the globe would question the basis of such allocation.

- **Variation between expected benefit anticipated against the actual benefit realised**

Participating entities enter into CCA and arrive at their respective contributions based on the expectation to derive substantial benefit out of the entire arrangement. It may turn out that the concerned activity actually may not be successful, resulting into losses instead of expected profit. In such case the Revenue authorities are likely to challenge the contributions ratios. The taxpayers in such situation would be called upon to demonstrate whether the independent enterprises would have continued their participation to the CCA in a comparable situation.

- **Measurement of each entity's contribution to the CCA**

Challenges arise when the contribution made by a participating entity is not entirely by cash. A quintessential example would be a case where the entity applies common resources for the purpose of CCA contribution as well as for the purpose of its regular business activities. In such case, it may get extremely intricate to measure the real value of the contribution by the said entity. Another issue arises while measuring and allocating savings that arise to a participating entity from Government subsidies or tax incentives.

- **Substantiating the allocation key used**

The genuine apprehension here is whether the allocation key used is appropriate considering the relationship between concerned activity and the expected benefit to be derived.

Robust documentation to mitigate transfer pricing risk

The way to tackle the challenges enlisted above is by each entity documenting the activities conducted, budgeted and actual expenditure incurred and the projections used to derive expected benefits from the activity. Also, each entity may be called upon to share the above information upon request as it might be of relevance to the revenue authorities while testing arm's length nature of the CCA.

CA Keval Doshi & CA Aparna Iyer

Benchmarking intra-group financing transaction

1. Background

In the recent past, tax authorities around the world have devoted increasing attention to inter-company financing transactions in terms of their tax treatment and pricing considerations. This attention is especially evident in the international arena, where several cross border financial transactions involving loan rates, guarantee fee charge and interest rate swaps could be difficult to comprehend and could potentially result in tax base erosion. For these intercompany financial transactions, there is a great deal of complexity for both the taxpayer and the tax authorities in determining a reasonable arm's length transfer price.

Financial engineering, especially in case of large acquisitions is common among multinationals as it aids in utilising excess cash balances within the group. It is also very typical for multinationals to extend intra-group guarantees as it helps them to leverage on entities where cash flows/assets give quality comfort to the lenders, which in turn helps in reducing overall group interest/ finance cost. Further using debt instead of equity is also commonly used to optimise investor returns as dividends in certain countries may suffer from tax leakage or in case of capital intensive projects, there may be time lag between cash flows and profit from operations.

2. Introduction

From an Indian transfer pricing perspective, while interest on intra-group loans, guarantees etc. have always been examined by the tax authorities, inter-company financing transactions (e.g. receivables/ payables) have grabbed more attention of Indian tax authorities in recent years, especially after the inclusion of "capital financing" in the definition of an "international transaction" by the Finance Act 2012. By virtue of clarificatory Explanation (i)(c) inserted by Finance Act, 2012 (with retrospective effect from 1st April, 2002), an "international transaction", as per Section 92B(1) of the Indian Income-tax Act, 1961 ('the Act'), shall include:

- Capital financing, including any type of long-term or short-term borrowing, lending or guarantee
- Purchase or sale of marketable securities or
- Any type of advance, payments or deferred payment or receivable or
- Any other debt arising during the course of business

In this backdrop, we shall discuss some of the common intra-group financing arrangements, related technical aspects and Indian jurisprudence in ensuing paragraphs.

3. Types of intra-group financing transactions in the Indian scenario

- **Inter-company loans**

One of the most common intra-group financing arrangements are in the form of inter-company loans.

In the case of benchmarking of loans from Indian transfer pricing perspective, an inbound loan is required to be benchmarked by both the lender and the borrower since, in such a scenario, the lender is a foreign company receiving interest income from its related party in India and thereby liable to tax in India. However, in case of outbound loan, typically only the Indian company (i.e. the lender) is required to undertake the benchmarking analysis since the foreign group company is the borrower paying interest and thereby not having income in connection to India, unless the borrower is taxable in India by virtue of having a permanent establishment in India/ tax resident in India and the loan transaction is effectively connected to such permanent establishment. Of course, the borrower entity may separately require to meet the ALP test in case it operates in a jurisdiction which is subject to transfer pricing.

In last few years, the loans granted by Indian companies to their subsidiaries abroad have attracted the attention of the Indian tax authorities for the purposes of transfer pricing scrutiny, especially in the cases where:

i. Loans granted by Indian companies to their subsidiaries are interest free loans; and

ii. The rate of interest charged by the Indian companies to their subsidiaries is based on Libor+/ Euribor+ basis points

In this regard, the lower level tax authorities have been contending the following:

i. Providing interest-free loans out of commercial expediency cannot be considered to be a valid justification; and

ii. The Indian Prime Lending Rate ('PLR') ought to be the ALP, and not Libor+/ Euribor+ basis points, to reflect what the Indian parent would have earned if the money had been lent in Indian Rupees. The prime reason for such a contention is because the Libor+/ Euribor+ basis points generally ranges between 3% – 6%, whereas, the Indian PLR ranges between 9% – 12%.

In respect of interest free loans given by Indian companies to their subsidiaries, the taxpayers have been contending that such loans are in nature of quasi-equity and may be considered in nature of shareholder's activity. Further, taxpayers have also argued that they do not charge interest on loans as they have been lent based on commercial expediencies and not with a motive to earn interest. However, the Tribunal rulings in the case of Perot Systems[1], VVF Ltd.[2], etc. have made it amply clear that an inter-company loan merits an interest payment and that it would be irrelevant whether the funds are lent out of interest-free advances or whether the loans are commercially expedient for the taxpayer. On the contrary, in the case of Micro Inks Ltd.[3], the Tribunal acknowledged regulatory hurdles pertaining to infusion of capital in the subsidiary and accepted the taxpayer's contention to treat the loan as 'quasi-equity' contribution.

In respect of interest rate to be considered for the purpose of benchmarking outbound loans, majority of Tribunal cases, including Siva Industries & Holdings Ltd.[4], Tech Mahindra[5], Four Soft[6], etc. have ruled that the ALP of the interest income should be computed

1 Perot Systems TSI (India) Ltd. vs. Dy. CIT [2010] 37 SOT 358 (Delhi)
2 VVF Ltd. vs. Dy. CIT [ITA No.673 (Mum.) of 2006]
3 Micro Inks Ltd. vs. Asstt. CIT [2013] 144 ITD 610/36 taxmann.com 50 (Ahd.)
4 Siva Industries & Holdings Ltd. vs. Asstt. CIT [2011] 46 SOT 112 (URO)/11 taxmann.com 404 (Chennai); Siva Industries & Holdings Ltd. vs. Asstt. CIT [2012] 54 SOT 49/26 taxmann.com 96 (Chennai)
5 Tech Mahindra Limited vs. DCIT (ITA No.1176/Mum/2010)
6 Four Soft Ltd vs. DCIT (ITA No.1495/HYD/2010)

corresponding to the currency of the inter-company loan, which should be Libor/ Euribor if it is denominated in foreign currency. The rational for adopting interest rate corresponding to the currency of the inter-company loan is that, if the borrowing entity (i.e. overseas Associated Enterprise) had borrowed in foreign currency from a local lender in its jurisdiction, such local lender would have charged the rate prevailing in such jurisdiction rather than adopting the PLR existing in parent entity country (i.e. India). Accordingly, the courts have upheld the use of Libor/ Euribor for benchmarking the interest income in case of inter-company loan transactions as opposed to PLR adopted by tax authorities at the assessment stage. Another reasoning that supports considering the corresponding currency would be that the interest rate corresponding to the currency also factors depreciation/appreciation of the currency. For example, return of a foreign currency denominated loan would be expected to appreciate vis-à-vis Rupee denominated loan owing to the appreciating nature of the foreign currency and hence it would be more practical to consider interest rate on a Libor/ Euribor basis vis-à-vis PLR basis.

Further, in the case of Aithent Technologies[7], the Tribunal has laid down the parameters to be considered for determining an ALP for an inter-company loan viz.; credit quality of the borrower, terms of the loan (the period of the loan, the amount, the currency, the interest rate basis) and additional inputs such as convertibility.

In case of inbound loans, so far, granting of loans at interest rate lower than arm's length rate by foreign Associated Enterprise ('AE') to Indian subsidiaries did not merit much scrutiny on the basis of the taxpayers' argument that, as per section 92(3) of the Act, section 92 is not intended to be applied in cases where the adoption of ALP determined under the regulations would lead into a reduction in the overall tax incidence in India in respect of the parties involved in the international transaction. However, the aforementioned argument would need to be reconsidered in the light of the recent Kolkata special bench ruling in case of Instrumentarium Corporation Limited, Finland[8] wherein foreign company (Assessee) entered into an agreement to advance an interest free loan to its AE in India which was a loss making entity. The special bench held that increase in ALP of the international transaction of foreign company does not provide for a corresponding adjustment/deduction in the hands of Indian AEs under Indian law. Further, it also emphasised on the fact that in such cases time value of money also would have to be taken into consideration and what would have to be seen is the impact on profits or losses for the year under consideration itself and there is no scope for taking into account the impact on taxes for the subsequent years (as the losses of the Indian AE would be set-off against future profits).

The ruling clearly lays down the need to undertake an independent benchmarking in the hands of the foreign entity irrespective of the impact the ALP would have on the tax base in India. While the ruling can be appealed at Higher Appellate Levels on questions of law, considering that the Special Bench (being a corrigendum of three members at the Tribunal Level) has upheld such a view, the tax authorities at the lower level are likely to adopt such a view until further update. Therefore, the taxpayers (especially the foreign companies) would need to review their positions wherein tax base erosion has been considered as the only argument to defend the ALP and plan the way forward.

7 Aithent Technologies (P.) Ltd. vs. ITO [2012] 134 ITD 521/17 taxmann.com 59 (Delhi).

8 Instrumentarium Corporation Limited, I.T.A. Nos.1548 and 1549/Kol/2009-

- **Guarantee transactions**

In India, disputes in respect of guarantee transactions are mainly in respect of legal interpretation of definition of International transactions covered under the Indian transfer pricing regulations. It may be noted that the definition of international transaction does not explicitly cover guarantee transactions, however, service transactions and residuary category of transactions which have an ultimate bearing on profits, losses, income and assets of the taxpayer do get covered under the ambit of the definition of international transactions.

In the case of a guarantee transaction, hypothetically, a liability would arise for the guarantor if a default took place and such liability would have an impact on the present/ future profits, incomes, losses or assets of guarantor. Based on this hypothesis, the Tribunal in the case of Bharti Airtel[9] and Videocon Industries[10] ruled in favour of the taxpayer by concluding that a provision of guarantee is not an "international transaction" as per section 92B of the Act. On the contrary, Tribunal rulings in the case of Kohinoor Foods Ltd.[11], Apollo Healthstreet Ltd.[12] and Nimbus Communication[13] have continued to treat the guarantee fee as an international transaction by ruling that a guarantee transaction is akin to provision of a service since it entails a commitment entered into by the assessee with the third party lender of the AE and obliges the assessee to cover the risk of default by its AE. Hence, the guarantor ought to charge a price to cover the default risk on behalf of the AE.

Further, much like inter-company loans, the transaction of provision of guarantee has also been abuzz with the concept of 'quasi-equity' and accordingly not charging guarantee fees. In 2011, the Bombay High Court in the case of Hindalco[14] ruled against the taxpayer's contention that a guarantee provided to a subsidiary is to further the taxpayer's own interest and hence does not constitute a service provided to the subsidiary.

Another interesting stand was taken by the Tribunal in the case of Micro Inks[15], where the Tribunal recognised the concept of shareholder's activity given by OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ('OECD TP Guidelines'). The Tribunal relying on examples held that, the taxpayer has discretion to decide the manner in which it wished to fund its subsidiary and in case the taxpayer has given guarantee on behalf of its subsidiary for financing its operations then, such guarantee is in nature of shareholder's activity, while on the other hand, in case the guarantee is given on behalf of subsidiary in order to make further acquisitions / investments, then such guarantee cannot be considered as shareholder's activity. However, the Tribunal made it clear that the taxpayer's stand from inception should be that transaction is in nature of shareholder's activity and hence, it has not recovered fee from its AE.

Further, in order to determine the ALP for provision of guarantee, the tax officers have often resorted to bank guarantee rates and external website quotes. However, in several cases such as Asian Paint[16], Everest Kanto Cylinders[17], Glenmark Pharmaceuticals[18], etc. the Tribunal has ruled against the use of third party bank quotes and website quotes

9 Bharti Airtel Ltd. vs. Addl. CIT [2014] 63 SOT 113/43 taxmann.com 150 (Delhi – Trib.)
10 Videocon Industries Ltd. vs. ACIT [2015] 55 taxmann.com 263 (Mum. – Trib.)
11 Kohinoor Foods Ltd. vs. Asstt. CIT [2015] 67 SOT 108/[2014] 52 taxmann.com 454 (Delhi)
12 Apollo Health Street Ltd. vs. Dy. CIT [2015] 67 SOT 64/[2014] 48 taxmann.com 41 (Hyd.)
13 Asstt. CIT vs. Nimbus Communication Ltd. [2013] 145 ITD 582/34 taxmann.com 298 (Mum. – Trib.)
14 Hindalco Industries Ltd. vs. Addl. CIT [2013] 359 ITR 46/[2012] 211 Taxman 315/17 taxmann.com 187 (Bom.)
15 Micro Inks vs. ACIT (ITA No. 2873/Ahd/10)
16 Asian Paints Ltd. vs. Addl. CIT [2014]149 ITD 511/41 taxmann.com 71 (Mum. – Trib.)
17 Everest Kanto Cylinder Ltd. vs. Asstt. CIT [2014] 52 taxmann.com 395 (Mum. – Trib.)
18 Glenmark Pharmaceuticals Ltd. vs. ACIT [2014] 62 SOT 79 (URO)/43 taxmann.com 191 (Mum. – Trib.).

for determination of guarantee fees. An important observation made by the Tribunal in the case of Glenmark Pharmaceuticals was that bank guarantees cannot be considered similar to corporate guarantees as banks provide guarantees as part of their routine course of business as a fool proof instrument of security. Hence, bank guarantee rates tend to be higher. Corporate guarantees, on the other hand, are provided in order to safeguard the financial health of the AEs and are not fool proof methods of security. Further, typically in case of bank guarantees, banks would have access to the complete books of account of the borrower to enable the banks to evaluate risks involved etc. and determine guarantee fees unlike corporate guarantees where the risks involved may be a higher. The distinctions become particularly important in the context of applying bank guarantee rates on a blanket basis to corporate guarantee transactions.

Having noted the above rulings, limited guidance emerge on actual determination of ALP for inter-company guarantees. Relying on international best practices, especially the case of GE Canada[19], it can be said that the "interest saving approach" is one of the better ways of determining such fees. The approach measures the benefit accruing to the borrower through the reduced interest rate payable to the third party lender as a result of the enhanced credit rating conferred to the borrower as a result of a parental guarantee.

On a related note, there could also be other forms of guarantee such as "comfort letters", "undertakings", "keep-well agreements", i.e. a non-legally binding "promise" or a "declaration" by the parent company to ensure the subsidiaries' financial stability to prevent it from defaulting. Though not examined in the Indian context, while one could argue these transactions merit guarantee fee payments, another view could be possible that these are mere commitments that lack legal enforceability and hence should not be recognized as a guarantee transactions. However, factual nuances in each case would need to be critically examined to reach an appropriate conclusion.

- **Interest on outstanding receivables**

Outstanding receivables are a normal part of any business activity and are a result of subjective commercial decisions by companies. Outstanding receivables, typically being an outcome of the sales/services transactions, these cannot be regarded as separate transactions which can be viewed on a standalone basis. However, with the amendment in the transfer pricing regulations by the Finance Act, 2012, any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business have been specifically included in the definition of international transaction under the provisions of Section 92B of the Act.

Some of the key arguments taken by the taxpayers in favour of the position of non-requirement of charging interest on overdue debts have been interest not being charged to the third party debtors in case of over-due receivables or in some cases, delays have happened due to overseas group companies booking/ payment cycles etc. However, the approach of the tax authorities, in general, has been towards disregarding the above arguments taken by the taxpayer and benchmarking such transactions by treating the same as loans and applying "Other Method" by considering domestic interest rates/ average cost of borrowing of the taxpayer without analysing the commercial terms and business exigencies.

Also, one could argue that interest on such outstanding receivables should not be levied in cases where weighted average payment period in case of controlled transactions is less than weighted average payment period of uncontrolled transactions in same/ similar circumstances (e.g. taxpayer selling to AEs as well as Non-AEs).

19 GE Canada 2009 TCC 563, dated 4-12-2009

In some instances, taxpayers have also argued that in a Transactional Net Margin Method ('TNMM') scenario, the additional credit period granted by the taxpayer to its AEs could be taken into consideration by performing a working capital adjustment. Thus, the excess credit period granted by taxpayer to its AE would be more than adequately covered or remunerated if the taxpayer earns a much higher margin as compared to the comparable companies. With respect to the same, there are two contradictory rulings from the Delhi Tribunal. In the case of Kusum Healthcare[20], it was held that no additional imputation of interest on the outstanding receivables is warranted if the pricing/profitability is more than the working capital adjusted margin of the comparables. However, in the case of Ameriprise India[21], the Tribunal did not agree to this position by reasoning that working capital adjustments are based on opening and closing values while the deferred receivable needs to be seen on a transactional basis.

In light of the above mixed approach followed by the tax authorities, it would be advisable for companies to have the facts and business circumstances appropriately documented especially with respect to advances received from the group companies, the credit period to third parties, etc. This could be used to support the principle argument that overdue debts is not a separate transaction which can be viewed on a standalone basis and thereby provide for adequate defence in matters before the tax authorities.

- **Hybrid instruments**

Apart from plain vanilla loan and equity options, multinational enterprises are now shifting to other forms of financing such as convertible debentures, bonds, preference shares etc. These instruments are cheaper alternatives for borrowers as compared to equity based funding and are frequently referred to as "hybrid" as they contain characteristics of both debt and equity. Owing to the nature and the specific terms & conditions pertaining to such hybrid instruments, various tax disputes are emanating around it, especially with respect to benchmarking of the resultant interest or dividend transactions.

Taking an example of a Compulsory Convertible Debenture ('CCD') *vis-à-vis* Optionally Convertible Debenture ('OCD'), in case of a CCD, which would be treated as debt until conversion, the equity upside would be taken care of at the time of conversion. However, in case of an OCD owing to the "option" the option that investor has to convert into equity, the investor should ideally get a premium over and above interest that one would receive on a CCD. Accordingly, it would become essential to dissect the interest and premium components and benchmark accordingly.

The issue on account of interest pertaining to CCDs was recently dealt in the case of India Debt Management Private Limited[22]. In this case, the taxpayer, engaged in the business of identifying investment opportunities in financially distressed companies, had issued CCDs to its AE. It treated the CCDs as a plain vanilla debt and issued INR denominated CCDs to its AE and benchmarked the interest using Bloomberg, LPC loan Connector, BSE debt instrument data, etc. The tax officer rejected the benchmarking done by taxpayer on the contention that the taxpayer did not mention the tested party. The tax officer treated taxpayer as the tested party and applied the ECB and US Corporate bond rate under CUP as an arms-length interest rate. The Mumbai Tribunal rejected the contention of tax officer as well as the Dispute Resolution Panel on the following key grounds:

- Concept of tested party is not important while applying CUP
- The base rate on which the interest rate depends is directly related to the currency

20 Kusum Healthcare (P.) Ltd. vs. ACIT [IT Appeal No. 6814 (Delhi) of 2014]

21 Ameriprise India (P.) Ltd. vs. ACIT [IT Appeal No. 2575 (Delhi) of 2014]

22 India Debt Management Private Limited IT (TP) A No. : 7518/Mum/2014

or denomination of issuance and, therefore, it should be taken into account according to the market conditions prevalent in the country of the said currency

- Relying on the decision rendered by the Hon'ble Delhi High Court in *CIT vs. Cotton Naturals P. Ltd.*, it held that arm's length interest rate should be computed based on market determined interest rate applicable to the currency in which the loan has to be repaid.

While much international guidance is not available with respect to benchmarking of such hybrid instruments, the above case law serves as a reference point. However, it would be essential to deep dive into the exact characteristics, terms and conditions etc. of such hybrid instruments while determining the ALP.

4. Impact of OECD-BEPS project

On 5th October, 2015, the Organization for Economic Co-operation and Development (OECD) released Final Reports on all 15 focus areas identified in its Action Plan on Base Erosion and Profit Shifting (BEPS). The BEPS package provides 15 Actions that equip governments with the domestic and international instruments to revise the current international tax rules and treaties.

In this regard, as a part of the BEPS Action Plan, the OECD has specifically released its Final Report (Action 4) on recommended limitations on interest expense deductions. In the document, "Limiting Base Erosion Involving Interest Deductions and Other Financial Payments", the OECD recommends that countries implement a "fixed ratio" rule that would limit net interest deductions claimed by an entity (or a group of entities operating in the same country) to a fixed percentage of earnings before interest, taxes, depreciation and amortisation ('EBIDTA'). This ratio should be somewhere between 10% - 30% of applicable EBIDTA. The Final Report further recommends that countries may adopt a "group ratio" rule to supplement (but not replace) the fixed ratio rule and to provide additional flexibility for highly-leveraged groups or industry sectors. Under the group ratio rule, for example, an entity with net interest expense above a country's fixed ratio could deduct such interest expense up to the level of the net third-party interest/EBITDA ratio of the worldwide group to which it belongs.

In the Indian context, while the above Action Plan has not yet been implemented, there are laws in place on limiting interest deduction, for e.g. the extant exchange control regulations have checks and balances on limits on borrowing and interest payment for various types of foreign debt to moderate leveraging. From a tax perspective, the interest on outstanding debt is deductible for tax purposes only if it is taken for business purposes. Further, India has very stiff withholding tax regulations and related party interest payments are also subject to transfer pricing scrutiny. In view of the above and considering that India's current economic policies are geared towards encouraging greater investment in India to complement several flagship programmes like 'Make in India', 'Digital India', etc. impact of this action plan merits special consideration.

5. Conclusion

The issues surrounding inter-company financing transactions are manifold leading to increase in number of anticipated transfer pricing scrutiny. It thus becomes extremely crucial to appropriately analyse and document such transactions upfront.

Also, for high-value transactions, the Advance Pricing Agreement route could also be explored by the taxpayers to help mitigate the risk and exposure to tax adjustments during audit stages.

(The views expressed in the article are authors' personal views. In no way they should be interpreted to be views of author's employer or any professional organisation with which authors are associated. Further, it may be noted that this Article contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. On any specific matter, reference should be made to the appropriate advisor.)

CA Anushree Jagnani & CA Rakesh Alshi

OECD BEPS Guidance on Intangibles

New OECD Guidance on Intangibles

Transfer pricing has risen to the forefront of international tax issues in the last two decades. The so-called 'new economy' of the 21st century has seen multinational business enterprises ('MNE'), turning to intangible assets to enhance their business potential, in a world increasingly focused on ideation, innovation and technology.

Given the increasing importance and relevance around intangibles, MNEs have efficiently structured their entire business operations around intangibles. An increasing number of MNEs have transferred their valuable intangible property to low–tax jurisdictions and realised the significant benefits. MNEs such as Pfizer, Google, and Microsoft have relocated a considerable part of their research and development ('R&D') investments and patents from their home countries to low - tax jurisdictions. Others founded trademark holding companies in tax havens that own and administer the group's brands and licences. E.g. Vodafone's, Starbucks, Apple and Shell's in tax havens from where they charge royalties to operating subsidiaries worldwide. Worldwide governments and tax authorities have raised increasing concerns about the opportunities for base erosion and profit shifting resulting from the transfer of intangibles among group entities.

With the objective of addressing these issues, the OECD through the BEPS project has revised Chapter VI of the TP Guidelines ('guidance') which provides guidance to ensure that the transfer pricing rules secure outcomes that are aligned with value creation. The guidance focuses on ensuring that the profits associated with the transfer and use of intangibles are appropriately allocated to economic activities which generate them. To facilitate this approach, the guidance emphasises on thorough delineation of transactions between associated enterprises (AEs) involving identification of roles and responsibilities relating to value creating functions and risk associated with them. One of the manifold complexities associated with intangibles has been identifying intangibles, which has also been addressed in the guidance.

> World's largest accommodation provider - owns no real estate
>
> World's largest taxi company – owns no vehicle
>
> It's all a game of INTANGIBLES

Definition of intangibles

The conceptually vague nature of the intangibles has been one of the problems in identifying intangibles in practice. The 2010 OECD Guidelines (paragraph 6.2) stated that:

"The term "intangible property" includes rights to use industrial assets such as patents, trademarks, trade names and designs or models. It also includes literary and artistic property rights, and intellectual property such as know-how and trade secrets. This chapter concentrates on business rights, that is intangible property associated with commercial activities, including marketing activities. These intangibles are assets that may have considerable value even though they may have no book value in the company's balance sheet."

In the Indian context, the legislators felt a need to amend the definition of international transaction defined under section 92B of the Income-tax, Act, 1961 ('the Act'), in order to clarify the true scope of the meaning of the term "international transaction" and to clarify the term "intangible property". Accordingly, an Explanation to section 92B of the Act was inserted *vide* Finance Act, 2012, with retrospective effect from 1st April, 2002, as under:

'(i) The expression "international transaction" shall include -

...

(b) The purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

Additionally the expression *"intangible property"* was also given a broad definition to include a wide variety of intangible assets including marketing related intangibles, technology related assets, customer related intangibles, location related intangibles, amongst others. It is also worth noting the definition of intangible property outlined in section 2(11) of the Act wherein, intangible assets are defined to include "know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature".

In most respects, the definition under the new guidance is unchanged from 2010 OECD Guidelines. The new guidance adopts a broad definition, whereby the term "intangible' is intended to address something:

1. *That is not a physical asset or a financial asset;*
2. *Which is capable of being owned or controlled for use in commercial activities; and*
3. *Whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances*

The above definition acknowledges existence of intangibles irrespective of accounting treatment, legal definitions, protection, reporting requirements, and is not dependent on or intended for use for any other tax purposes. In identifying intangibles for transfer pricing purposes, the guidance focuses on what would be agreed between unrelated parties in a comparable transaction. The guidance notes that a transfer pricing analysis should carefully consider whether an intangible exists and whether an intangible has been used or transferred (for example, not all expenditure related to marketing or research results in creation or enhancement of an intangible).

Definitions have also been provided for "marketing intangibles" and "unique and valuable intangibles" to facilitate identification of intangibles. However, it is emphasised that generic references to such definitions do not relax taxpayer's / tax administration's obligation to identify relevant intangibles with specificity, nor does the use of these terms suggest that a different approach should be applied in determining arm's length conditions for transactions involving them.

Typical intangible transactions

The guidance distinguishes between intangibles and market conditions / local market features which are incapable of being owned, controlled or transferred. It is acknowledged that in some circumstances local market features may affect the determination of an arm's length price for a particular transaction. For instance, the high purchasing power of households in a particular market may affect the sales and prices paid for certain luxury consumer goods. Similarly, low labour costs, proximity to markets, favourable weather conditions may affect prices of particular goods and services in a particular market. However, given that such market specific characteristics are not capable of being owned or controlled, they do not qualify as intangibles as per the guidance but should be considered in a comparability analysis. The identification of an item as an intangible is separate and distinct from the process of determining the price for the use or transfer of the item.

Intangibles for tax purposes	**Not intangibles for tax purposes (as they are not capable of being owned or controlled or transferred)**
Patents	Group synergies (Assembled workforce)
Know-how and trade secrets	Market specific characteristics (e.g. local purchasing power, location savings, proximity to markets)
Trademarks, trade names and brands	
Rights under contracts and Government licences	
Licences and similar limited rights in intangibles	
Goodwill and ongoing concern value	

Location savings

Location savings refers to the net reduction in costs enjoyed by an entity by relocating operations from a high-cost jurisdiction to a low-cost jurisdiction. The cost savings may result from a number of factors like labour costs, raw material costs, transportation costs, rent, training costs, incentives including tax exemptions and infrastructure costs, etc. The guidance identifies location savings arising from locational advantages as a market characteristics that may affect the determination of an arm's length price for a particular transaction and therefore should be considered in a comparability analysis. Given that location savings cannot be owned or controlled, they do not qualify as an intangible as per the new guidance. However, the Indian transfer pricing regulations under the Act adopt a contrary view. As per the explanation to Section 92B of the Act, term "Intangible property" includes location related intangibles assets. Therefore, under the wide definition of intangibles under the Act, location savings are considered as intangibles from an Indian transfer pricing perspective. Similarly, market premium is also regarded as a market characteristics, not an intangible under the new guidance, while India recognises it as an intangible.

Assembled workforce

Some businesses are successful in assembling a uniquely qualified or experienced category of employees. The existence of such a workforce may affect the arm's length price for services provided by the workforce or the efficiency with which the services are provided or goods are produced. Therefore, the guidance states that such factors should be taken into account in a transfer pricing comparability analysis and are not an intangible (as work force cannot be owned or controlled by a single enterprise). However, the Indian TP regulations consider trained and organised work force as an intangible.

Entitlement to return from intangibles and DEMPE functions

The guidance focuses on ensuring that the profits associated with the transfer and use of intangibles are appropriately allocated in accordance with value creation. Section B of the guidance addresses the difficult question of how to allocate the overall profit created by an intangible among the functions involved, assets used and risk associated with the intangible.

The guidance clarifies that legal ownership alone does not necessarily confer a right to all of the return that is generated by the exploitation of the intangible. It is emphasised that the group companies performing important functions, controlling economically significant risks and contributing assets in development, enhancement, maintenance, protection and exploitation ("DEMPE") of the intangible, as determined through the accurate delineation of the actual transaction, should be entitled to an appropriate return reflecting the value of their contributions. The Guidance leverages on the framework for analysing risk provided in Chapter I (exercising control over functions and having financial capacity to assume the risk) to determine which parties assumed risk in relation to intangibles, and for assessing which member of the group controlled the performance of DEMPE functions in relation to intangibles.

The guidance states that in identifying and determining the entitlement for DEMPE functions performed, it is important to note that some "important functions" will have special significance because they usually make a significant contribution to the intangible value. Such functions may include:

- Design and control of research and marketing programmes
- Direction of and establishing priorities for creative undertakings, including determining the course of research
- Control over strategic decisions regarding intangible development programme
- Management and control over budgets
- Important decisions regarding defence and protection of intangibles
- Ongoing quality control over functions performed by others that may have a material effect on the value of the intangible

Therefore, particular attention should be devoted to analysing the decision making and control functions associated with the development, enhancement, maintenance, protection and exploitation of intangibles that drive value creation in a business.

Where the conduct of the entities does not support the contractual relationship, the actual conduct of the entities takes priority over the legal contractual relationship, and the profits from the arrangements are allocated to the entity that makes the key contributions to the creation of these profits.

In practice, any of the DEMPE functions may be performed by another party whose specialised knowledge makes it the sensible, from a business perspective, to rely on the other parties' judgment. The guidance focuses on the need to investigate and identify the activities of "significant importance" in order to determine the arm's length entitlement vis-à-vis the different segments of the DEMPE functions. Typically, DEMP functions may be performed by a single entity while the intangible is exploited by multiple group entities. In such a scenario, a thorough delineation of the DEMPE functions performed and the risk assumed would be required to determine the allocation of intangible related returns. Though little guidance has been provided on how to practically allocate intangible returns among multiple entities that together contribute to the creation of the valuable intangible through DEMPE functions.

The guidance recognises that the legal owner need not be the one to carry out all the DEMPE functions itself, but acknowledges that independent parties do engage others to perform such functions. In this context, the guidance clarifies that to be termed and priced as an "outsourced service", the control over such services (considered as ability to understand and evaluate the performance of functions, and taking the final decisions regarding important aspects) needs to be exercised by the enterprise claiming entitlement of intangibles related return. In this situation, an entity would be deemed to exercise control if it has the ability to understand the functions being performed, to determine if the functions are being performed adequately, and to be the final decision maker regarding important aspects of the functions. The guidance clearly provides that when the legal owner does not adequately control the outsourced activities, the party that in practice controls the outsourced activity should be appropriately compensated.

Further, the guidance provides a fresh approach to recognising and rewarding the entity that funds the performance of the DEMPE functions. It distinguishes between financial risk associated with funding a project and the operational risk associated with operational activities for which the funding is used. The guidance states that when the entity providing funding exercises control over the financial risk without assuming and controlling operational risk, it would be entitled to only a risk-adjusted return (such as the cost of capital). To exercise control over financial risk, the entity providing the funding must make the decisions with respect to the risk-bearing opportunity and respond to risks associated with the opportunity. Additionally, the funding entity must perform day-to-day risk mitigating activities regarding the management of financial risk or, if those activities are outsourced, exercise appropriate control over the outsourced activities. Mere funding of the DEMPE of an intangible by an entity, without performing any of the important functions in relation to the intangible, and without exercising control over the financial risk, will entitle the entity only to a risk-free return. This approach would transform the manner in which the return relating to intangibles is allocated to the legal owner of the intangible or the entity merely funding the DEMPE of an intangible.

Historically, legal ownership of intangibles was easy to shift from one place to another, thereby creating opportunities for IP planning/ structuring through "cash boxes", resulting in base erosion and profit shifting from the countries that originally developed the intangible. The cash boxes are cash rich entities located in tax havens which provide the opportunity to park excess returns of the group (attributable to the intangibles) in tax-effective regimes instead of taxing the profits in source countries (performing the DEMPE functions) having higher tax rates. In their capacity of the legal owner of the intangible, the cash box retains a significant part of the intangible related returns. In such scenarios, the intangibles related profits are typically captured by the cash box (intangibles owner) by licensing rights to others as well as by outsourcing the core R&D functions related to intangibles to affiliates (at times in low tax or low cost jurisdictions) for a routine return. This approach results in significantly reducing the tax outflow pertaining to intangibles related returns of the group, thereby reducing the global tax burden of the group.

However, the new guidance will revolutionise the manner in which the cash boxes retained the intangibles related returns. As per the guidance, the legal owner or the funding entity exercising control over the financial risk without assuming and controlling operational risk, would be entitled to only a risk-adjusted return (such as the cost of capital). Where the entity only provides funding of the DEMPE of an intangible by an entity, without performing any of the important functions in relation to the intangible, and without exercising control over the financial risk, it will be entitled only to a risk-free return on capital. Therefore the guidance will prevent cash-rich minimal functioning entity (a cash box) from earning a significant part of the intangible related return associated with the DEMPE functions (carried out by contract R&C centres who were historically receiving a routine return for provision of DEMPE functions but now would be appropriately compensated).

The impact of the application of the guidance on the typical intangibles transactions and structures from an India perspective have been discussed below.

Application of the guidance from an India perspective

In light of the new guidance, in future the entities will be required to identify and obtain a deeper understanding of how value is created with respect to development and exploitation of their intangibles. We analyse below the impact of the new guidance on some of the key intangibles related issues and structures from an India perspective.

A. *Marketing Intangibles*

Determination of the arm's length price of transactions involving marketing intangibles/ rights in such intangibles, as well as bearing cost associated with development/maintenance of marketing intangibles (advertisement, marketing and promotion ('AMP') expenses), has been one of the important TP issues in India.

The controversy primarily arises due to the divergent views of the tax authorities and the taxpayers on the importance of AMP expenses and their role in the process of creation, development and enhancement of the value of the marketing intangibles. Tax authorities contend that developing market or establishing brand is the duty of legal owner of the brand (IP Co) and the higher AMP expenses by local entity to enhance the value of the brand owned by IP Co, results in provision of "brand promotion services" to IP Co, for which they should be duly compensated. The taxpayers contend that the AMP expenses are incurred for the purpose of increasing the value of "their own intangibles" and not for provision of brand promotion services to IP Co. Over the past few years Indian subsidiaries have encountered significant transfer pricing adjustments on account of the alleged contribution to brand building in India for the IP Co by incurring excessive AMP expenditure.

The new guidance discusses the application of the principles in relation to development and enhancement of marketing intangibles (para 6.76 to para 6.78). The guidance observes that under long-term contract of sole distributor rights of the trademarked product, the efforts of the local entity may enhance the value of its own intangible viz. its distribution rights. A similar line of contention has been adopted by numerous Indian taxpayers where the expenditure incurred by them is for exploiting the intangibles in their prescribed territory, thereby increasing the value of 'their intangibles' and not that of the legal owner of the intangible. This view is to an extent aligned to the approach adopted by the Delhi High Court in the case of Sony Ericsson and others[1] and Maruti Suzuki India Ltd[2].

The guidance further opines that the remuneration for such functions can come in several forms such as separate compensation, reduction in price of goods, reduction in royalty rates, etc. Guidance suggests that where services and intangibles are intertwined, determining arm's length prices on an aggregate basis may be necessary. A similar view is taken by the Delhi High Court in the Sony case. The High Court ruled that taxpayers can either adopt a bundled approach (an aggregated/ bundled analysis with related transactions) or an unbundled approach for the purpose of benchmarking such functions.

It is pertinent to note that the new guidance discusses the concept of marketing intangibles

1 TS-96-HC-2015(Del)-TP
2 Maruti Suzuki India Ltd vs. CIT, ITA 110/2014, ITA 710/2015, Delhi HC, Year 2015

in the case of a distributor and not manufacturer. However, the Indian authorities have applied the concept of marketing irrespective of the functionality (distribution / manufacturer) and characterisation (limited risk / entrepreneur) of the Indian entity.

The taxpayers can draw support from the guidance on aspects such as long-term contract by virtue of conduct, exclusive rights to do business in specified territory, performance and control of functions, etc., while putting forth their contentions. Though clarity on the issue relating to marketing intangibles in India would be dependent on how the guidance impacts the view of the Indian authorities.

B. Location savings

Entitlement on benefits arising from location savings has been a litigative issue. The guidance identifies location savings arising out of locational advantages as a market characteristic that cannot be owned by anybody. Therefore, no extra profit can be attributed to an entity merely on account of it being located in a low cost jurisdiction, the attribution of profit should be based on arm's length principle only. The guidance states that location savings is a comparability fact and that if there exists local comparable uncontrolled transactions no separate compensation is required for location savings. But, the Indian tax authorities believe that there is a benefit from location savings which can be computed by considering the differential cost across countries. However, the jurisprudence in India (in the case of Watson Pharma) and the views expressed in the Rangachary Committee report on Safe Harbour Rules are aligned to the view proposed in the new guidance (i.e., where local comparables are considered for determination of the arm's length price, no separate compensation is required for location savings).

The new guidance also puts notable emphasis on whether the location savings is retained by a member or members of the MNE group or are passed on to independent customers or suppliers. Where the location savings is completely passed on to the customer or supplier, the return for location savings is not relevant. The Hon'ble Delhi High Court in case of Li & Fung[3] have also taken a similar view wherein the adjustment to income was deleted on the ground that the Indian tax administration failed to demonstrate the extent to which the overseas related party benefitted from locational advantages. In light of the above, the controversy around location savings has to a great extent been resolved.

C. Contract R&D and Patent box regime

In the last decade, India has emerged as an important location for MNE R&D centres. With the establishment of numerous R&D centres in India, availability of abundant and economical talent pool, and increased focus on brand-positioning for augmenting the business / market share, discussions on transfer pricing aspects of intangibles have dominated the Indian TP landscape in the past few years. The key issue revolves around the entitlement of the relevant parties (the intangibles owner and the R&D centres) over the intangibles related returns.

Traditionally, from a transfer pricing perspective, these Indian captive contract R&D service providers have been characterised as routine contract R&D service providers exposed to low / limited risk, warranting a routine cost plus return. Indian Revenue authorities have had divergent views on the matter i.e. vehemently contending that the R&D centres (of MNEs) in India have played a crucial role in developing the intangibles and accordingly these development centres should be characterised as full-fledged entrepreneurs / significant risk bearing entities. Given the controversy, the Central Board of Direct Taxes (CBDT) issued Circular No.6 / 2013 on 29 June, 2013 for addressing the transfer pricing aspects relating to development centres. The Circular lays down guidelines for identifying a development centre as a contract R&D service provider with insignificant risk. It emphasizes on the concept of substance over form and has focused

3 LI and Fung India Pvt. Ltd. vs. Commissioner of Income Tax [ITA 306/2012]

on the functional analysis and the related aspects of decision making, control, capital, supervision and monitoring, etc. in order to ascertain whether or not the IDC is a contract R&D centre with an insignificant risk. Where the development centre does not qualify as a contract R&D service provider with insignificant risk, allocation of routine cost plus return will not reflect an arm's length price for the services rendered.

The new guidance also provides clarity on the approach to be followed for identification of the intangibles, ownership (legal or economic), approach for the comparability and selection of transfer pricing method for determination of the arm's length price. In this respect, several aspects of the revised guidance are in line with the practices followed by the Indian tax authorities. The revised guidance, for instance, emphasises supplementing (or replacing, where appropriate) the contractual arrangement through examination of the actual conduct of the parties based on the functions performed, assets used, and risks assumed, including control of important functions and economically significant risks. This approach finds support in CBDT's Circular No. 6/ 2013 ('Circular'). The alignment of functional contributions and financial investment with legal rights is seen in the circular as well.

D. Patent box regime

Given the litigation around the role of contract R&D centres and their entitlement over the intangible related returns, a number of countries are increasingly introducing innovative tax regimes that provide for a preferential treatment in respect of profits derived from intangibles. This preferential tax regime is offered to support growth and innovation and to encourage companies to locate activities associated with development of intangibles/ patents in the country. Such a regime typically grants a lower tax rate on profits arising from development of the intangibles, "boxing" them off from the rest of the system (patent box regime). The focus is on providing preferential tax regime only to those cases where value is created in the jurisdiction. Thus, the tax base of a country is protected from artificial profit shifting and the jurisdiction which deserves gets due share of tax revenues.

On similar lines and given the significant litigation in India around this issue, India has also introduced the patent box regime. Historically, R&D incentive in India had been "input based," i.e., by granting weighted or accelerated deduction on eligible expenditure on R&D, though this incentive is now being phased out. In line with the global trend, the Finance Act, 2016 proposed a new regime in the Indian tax law under which income earned by a qualifying taxpayer from the exploitation of a patent would be taxed at a preferential rate. With the implementation of patent box regime in India, the functionality of the Indian contract R&D service providers can be enhanced which would align R&D activities with the intangible ownership and enable them to avail the benefits under the preferential rate.

Indian tax authorities have in audits investigated in detail the issue of the arm's length returns to entities that are not legal owners of intangible assets but are seen to have economic ownership.

Given the above, the existing R&D centres should take a deep dive into their actual functional and risk profile to align the allocation of intangible related return to the location where the value is created and also avail the preferential patent box regime.

Use of valuations

The guidance acknowledges the difficulties or rather the special considerations in relation to determining an acceptable arm's length transfer price for intangible transactions. The transactions could be in the nature of outright sale, or royalties under licensing arrangements, but it could also be more complicated transactions such as package of bundled intangibles, know-how contracts etc.

Section D contains guidance to determine the arm's length conditions (terms and pricing) for transactions involving intangibles. The guidance states that in order to apply "the arm's length principle to a controlled transactions involving intangible property, some special factors relevant to comparability between the controlled and uncontrolled transaction should be considered."

The guidelines provide for several factors for comparability of intangibles or rights in intangibles, even though this may result in raising the comparability bar too high to be complied with, given the lack of available data in the public domain with respect to transactions involving intangibles/ rights in intangibles. Also, in performing the comparability analysis and determining the arm's length compensation for an intangible transaction, the guidance provides for evaluating the options realistically available to the parties and cautions that one-sided comparability analysis would be insufficient. Given the unique nature of the intangibles transaction, the guidance also observes that the CUP method, transactional profit split and discounted cash flow techniques could be highly useful. However, any selected method and the comparability adjustment, if any, should take into account all the relevant factors that materially contribute to the creation of value and not just the intangibles or routine functions.

From India Transfer Pricing perspective, DCF method has been ruled as the most appropriate method for valuation and has been increasingly used by the taxpayers for transactions pertaining to valuations of intangibles or transfer of shares. A similar view is held in ITAT rulings of Ascendas[4] and Visteon[5], where DCF method was considered as the most appropriate method for determining the arm's length price for sale of shares. Further, in ruling of DQ (International) Limited[6] it was held that in case of transaction involving sale of intangibles, due consideration needs to be given to the independent valuation report and the tax department cannot replace the projected cash flows with actual revenues at a later date for valuing such intangibles.

Specific guidance on hard-to-value intangibles

Section D of the guidance provides for the transfer pricing approach in relation to "hard-to-value" intangibles (HTVIs). HTVIs are defined as "intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises, (i) no sufficiently reliable comparables exist; and (ii) there is a lack of reliable projections, or the assumptions used in valuing the intangible are highly uncertain.

The guidance enables tax administrations to use ex post evidence on financial outcomes of an intangibles transaction (i.e. information gathered in hindsight) as presumptive evidence of the appropriateness of the pricing arrangements. The use of ex post evidence will be subject to safe harbours in certain situations. This includes cases where the taxpayer can provide reliable evidence that any variance between projections and the actual outcomes is due to unforeseen developments or foreseeable outcomes whose probability was originally estimated. Nevertheless, the ability of tax authorities to use hindsight to challenge taxpayers' pricing assertions results in an additional layer of uncertainty and documentation requirements for taxpayers.

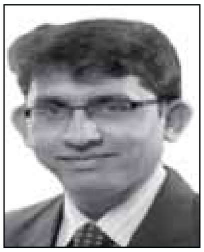
Conclusion and way forward

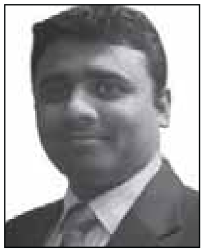
Based on the guidance provided in BEPS Action 8 in relation to intangibles, it is expected that the objective of aligning the transfer pricing outcomes with value creation may be achievable.

<u>The new guidance will mandate taxpayers to ensure that intangibled related returns are assigned to the entity responsible for the functions/risks that contribute to the creation of value.</u> The guidance is likely to be effective in preventing cash-rich minimal functioning entity from earning the substantial residual returns associated with DEMPE functions.

The guidance would require the taxpayer to obtain a deeper understanding of how value is created with respect to development and exploitation of their intangibles and ensure alignment with the transfer pricing policy. Additionally, from a practical perspective, it will be necessary for taxpayers to maintain contemporaneous documentation in support of their intangibles transfer pricing policy (which may also entail application of more resources). Therefore, taxpayers are advised to proactively consider the impact of the new guidance on their transfer pricing arrangements.

4 Ascendas (India) Private Limited vs. DCIT (ITA No. 1736/Mds/2011)
5 ViHI LLC vs. ADIT (ITA No.17 (Mds/2012)
6 DQ International Ltd. vs. ACIT (ITA No. 151/ HYD/2015)





CA Bhavesh Dedhia & CA Anjul Mota

Indian Transfer Pricing Documentation – Significant Changes to documentation norms

Rapid globalisation coupled with technological changes has resulted in proliferation in the business complexities, integration of various economies / markets, accelerating digitisation and thereby, revolutionised the governing regulations across the world.

The same has necessitated simultaneously evolution and synchronisation of the global tax regimes in order to control and monitor migration of economic activities and consequential taxes from high-tax to low-tax jurisdictions.

The evolving tax landscape has presented a unique opportunity to Multi-National Entity (MNE) groups to align their transfer pricing strategies with business realities.

Globally, robust documentation is the most crucial cog in the transfer pricing landscape, which amongst others, also helps to achieve the following broad objectives:

- Provide functional, risk and asset analysis bringing out functional characterisation of MNE Group entities across the globe;
- Ensure fair allocation of revenue between different entities / jurisdictions;
- Ensure meeting corporate governance standards;
- Providing crucial information required to conduct an informed TP audit; and
- Provide for safeguards from potential penalty for non-compliances.

We have tried to discuss below few aspects on the Indian transfer pricing documentation regulations and impact of the changes proposed by the Base Erosion and Profit Shifting (BEPS) project initiated by the Organisation of Economic Cooperation and Development (OECD) in 2013, at the request of the Finance Ministers of the G20 countries, in the Indian scenario:

I. Existing documentation norms

Under the extant Indian TP regulations enshrined in the Income-tax Act, 1961 (the Act) read with the Income-tax Rules, 1962 (the Rules), the onus of proof lies with the taxpayer, who is required to keep and maintain information and documents to support the pricing of its inter-company transactions, as per the provisions of section 92D of the Act. Rule 10D of the Rules prescribes the detailed requirements of information and documents to be maintained by a taxpayer (covered under **Annexure 1**).

Every taxpayer (aggregate value of international transactions does not exceed INR One Crore during a particular financial year) is obligated to maintain the prescribed information and documents for respective financial year on contemporaneous basis, on or before the due date of filing the Return of Income, i.e. 30 November following the end of the financial year. However, the said cap does not discharge the taxpayer from its responsibility to demonstrate the arm's length nature of its international transactions for transactions being less than INR One Crore.

II. Changes with respect to documentation requirements under Indian TP regulations

The BEPS project aims to ensure that profits are taxed where economic activities take place and value is created – this has resulted in 15 Action Plans being developed to achieve the aforesaid objective.

Amongst the others, the final report issued under the OECD / G20 BEPS project for Action Plan (AP) 13 focuses on **"Transfer Pricing Documentation and Country-by-Country Reporting"** – it has revised the entire Chapter relating to TP documentation of the OECD TP guidelines, namely Chapter V, to provide necessary information to tax administrators across the world, for identifying cases for TP audits, based upon "risk assessment".

The AP 13 contains a three-tiered standardised approach to transfer pricing documentation:

A. Master file

The AP 13 provides that the Master file should contain standardised high-level information overview regarding the global operations and TP policies, value-drivers relevant for all group members of an MNE. i.e., a blueprint of organisational structure, description of business and operations, intangibles, intercompany financial activities, and financial and tax positions.

Under the Indian TP regulations, the detailed rules for the maintenance and filing of master file are yet awaited. However, as appearing in the Memorandum to the Finance Bill 2016, it seems that the content of the Master file would be in line with the OECD BEPS report.

Non-furnishing or delay in furnishing the Master file could result into penalty of ` 5 lakh. However, reasonable cause defence against levy of penalty shall be available to the taxpayer.

A detailed list of information prescribed under AP 13 for the Master file is enclosed under **Annexure 2**.

B. Local file

A Local file would contain detailed information, being specific to intercompany transactions entered into by a local entity. Local file is intended to supplement the Master file, thereby helping to meet the objective of assuring that the taxpayer has complied with the arm's length principle in its material transfer pricing positions affecting a specific jurisdiction.

The information required to be maintained under a Local file is broadly similar to the information prescribed under Rule 10D of the Rules. A detailed list of information prescribed for Local file under AP 13 has been enclosed under **Annexure 3**. The following are the key additional requirements vis-à-vis documentation requirements under current Rule 10D:

- Description of the management structure of the local entity;
- Description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices;
- Detailed description of the business strategy pursued by the local entity;
- Key competitors;
- Copy of existing unilateral and bilateral / multilateral Advance Pricing Agreements and other tax rulings to which the local tax jurisdiction is not a party and which are related to controlled transactions

Under the Indian TP regulations, it is anticipated that the information / documents prescribed under the Rule 10D may be amended to include the additional documents prescribed under the AP 13. As of now, the revisions to Rule 10D is awaited.

C. Country-by-Country Reporting (CbCR)

CbCR presents an overview of allocation of income, taxes and business activities by jurisdiction and main business activities carried out by the group entities in respective jurisdictions.

The prescribed template for CbCR provides aggregate information about the functions performed, assets owned, personnel employed, revenue generated, profits earned, taxes paid, capital structure, retained earnings, etc., with respect to each entity of the MNE group located in different countries.

The AP 13 provides a minimum threshold of consolidated annual turnover of Euro 750 million for MNE groups to be obliged to comply with CbCR. The OECD recommended template for preparation of CbCR has been enclosed under **Annexure 4**.

Under the Indian TP regulations, section 286 has been introduced by the Finance Act, 2016, in order to introduce CbCR requirements, in line with the BEPS project. With effect from financial year 2016-17 i.e. for Assessment Year 2017-18, the CbCR is required to be filed by an Indian parent of an international group, only if the consolidated revenue of the international group in previous year 2015-16 exceeds the prescribed threshold [as per the Memorandum to the Finance Bill, 2016, the threshold is indicated to be INR 5,395 crore (Euro 750 million)].

For non-furnishing of the CbCR by an entity which is obligated to furnish it, a graded penalty structure would apply which include ` 5,000 per day (if default does not exceed one month) and ` 15,000 per day (for the period exceeding one month).

Further, for any default that continues even after service of order levying penalty, as above, then the penalty for any continuing default will be ` 50,000 per day.

If the entity has provided any inaccurate information in the CbCR, penalty of ` 500,000 applies subject to certain conditions.

Sharing of CbCR

CbCR will be shared automatically through Government-to-Government exchange of information. In limited / peculiar situations, secondary mechanisms, including local filing could be used.

In order to facilitate the effective implementation of the CbCR, the OECD released a standardised electronic format in March 2016, for the exchange of CbCR amongst jurisdictions. This includes the CbCR XML Schema as well as the related User Guide. CbCR is to be electronically transmitted between Competent Authorities in accordance with the CbCR XML Schema. The first exchanges would commence in the year 2018, for the information relating to the year 2016.

As on 30th June, 2016, 44 countries, including India, have signed up for Multilateral Competent Authority Agreements for implementation of the exchange of CbCR.

III. Corresponding anticipated changes to the Indian TP regulations and potential issues to be addressed

1 The threshold limit for applicability of Master File and exact documentation requirements with respect to Master File and Local File are awaited.

Adequate time needs to be provided to the taxpayers to compile and file documents with the prescribed authorities.

2 Purpose of reporting and filings – OECD BEPS AP 13 provides that the information

in the CbCR template "may be useful in risk assessment processes" and "should not be used as a substitute for a detailed transfer pricing analysis".

Taxpayers eagerly await the instructions to be issued for Indian field officers, in line with India's commitment to implement BEPS APs under the OECD standards.

3 Resource allocation – Given the wide range of information required to be disclosed in the Master File, Local File and CbCR, appropriate use and application of the information would require a detailed analysis and focused audit.

Adequate resources need to be allocated for the same, by the taxpayers as well as by the tax authorities.

4 Transparency and accountability – Indian taxpayers could face the risk of prolonged litigation and double taxation, in cases where the audit procedures, dispute avoidance and resolution procedures are not efficiently designed and implemented, in coherence with the international practices. Thus, transparency and accountability is required from both – tax authorities as well as taxpayers.

IV. Potential concerns for the taxpayers

In relation to the above, we have tried to identify few issues which taxpayers are facing to comply with new documentation requirements:

1. Diversified business and constant regulatory changes

Large MNE Group is generally engaged in diversified business with decentralised functions / activities at region-level given the nature of the business, supply chain dynamics, costs involved, etc.

In such cases, the business models, policies, functions and risks undertaken, etc. may be different for each country / region.

Further, such MNEs may face difficulties in deciding as to who will prepare / maintain master file / CbCR for respective businesses and convey consistent story and results, notwithstanding the differences in regulatory reporting norms, reporting periods, currencies, conversion rates, etc.

Also, given the constant changes in the regulatory regimes across the globe and especially in India like IND-AS, Goods and Services Tax (GST), Companies Act, etc., the business models may be required to be constantly adapting to regulatory changes and trying to align themselves to be in line with their corporate and shareholder interests.

2. Country-level Consolidation of results

At present generally, large MNEs consolidate their business results for various group entities operating in multiple countries at the levels of business units, products, etc. The new documentation norms would place additional burden on the MNEs to consolidate results of multiple entities with diversified business at a particular country-level.

E.g. XYZ Group is operating in 20 countries through 100 legal entities / franchise and deals in products i.e. mobile phones, perfumes, footware, watches etc. It carries out functions such as manufacturing, assembly, distribution, etc. in various countries. Let's assume that in India, it is operating through 10 legal entities or franchisees. At present, it may be capturing results for various products or business across 20 countries for 100 entities but going forward, it would need to capture results of all the legal entities in respective country. In the instant case, it would need to consolidate results of all the 10 entities in India which otherwise was not required. This would place an additional burden on the MNE Group.

MNEs are also facing practical implementation issues e.g., aligning different accounting principles / conventions, different software adopted by entities located in different countries

/ regions, etc, thereby leading to the possible difference in the results.

3. Confidentiality of information

Several MNEs are concerned that new documentation norms requires them to file information about their Global operations, TP policies, value-drivers, intangibles etc. These information are highly confidential and provide competitive edge to the MNE Group. Adequate safeguards needs to be designed internally by MNE Group and implemented to protect such information.

4. Meeting expectations of different regulators in different countries

To illustrate, a MNE having routine back office support service provider for Asia region in India and for Americas region in Brazil, may face difficulty in providing similar arm's length remuneration in both jurisdictions given the regional factors, currencies, comparables' margins, etc, despite both entities performing similar functions and undertaking similar risks.

The aforesaid situation could complicate further especially in activities like high-end manufacturing, design, R&D, etc.

Taxpayers would need to define the entire value chain in the files, detailing each entity's categorisation in line with their functional and risks profile. The same should reflect the actual conduct of the respective entities.

5. Planning for litigation / alternate dispute mechanism

With availability of wide ranging information at the disposal of the tax authorities of various countries, it would be imperative for taxpayers to proactively prepare for detailed audits, cross-country / cross-region comparison within the group, usage of secondary benchmarking, etc.

Incrementally, it would be essential to evaluate different alternate dispute resolution processes such as Advance Pricing Agreement (APA) – unilateral / bilateral / multilateral, Mutual Agreement Procedure (MAP), Safe Harbour, etc. actively seek ways to mitigate the onerous local documentation requirements and simultaneously, to resolve potential disputes.

Conclusion

India has taken the first steps towards aligning its transfer pricing regulations with the international practices, by ushering in the Master File and CbCR requirements. As seen above, the renewed TP regime is expected to bring about a sea change in the approach and processes, at the both ends i.e., taxpayer as well as tax authorities.

The same would require foresight and careful approach and well thought-out planning at global, regional and local levels of the respective businesses to align the reporting and documentation with the ever-changing business needs to present consistent, stable and cost-effective compliance with several regulations across the globe.

Annexure 1

Requirements of Rule 10D – Prescribed information and documents to be maintained

<u>Every taxpayer who has entered into an international transaction and specified domestic transaction, is required to keep and maintain the following information and documents namely</u>:

- Description of the ownership structure of the taxpayer
- Profile of the multinational group
- Broad description of the business of the taxpayer
- Broad description of the industry in which the taxpayer operates

- Broad description of the business of the associated enterprises and related parties
- Nature and terms (including prices) of international transactions and specified domestic transactions
- Description of the functions performed, risks assumed and assets employed by the taxpayer as well as the associated enterprise
- Record of economic and market analyses, forecasts, budgets, etc. as prepared by the taxpayer
- Record of uncontrolled transactions, if any, and analysis performed to evaluate comparability of uncontrolled transactions
- Description of the methods considered for determining the arm's length price, rationale for selection of a particular method as the most appropriate method, and the application of the same
- Record of actual working carried out for determining the arm's length prices, including details of the comparable data and financial information, and adjustments, if any
- The assumptions, policies and price negotiations, if any, which have critically affected the determination of arm's length price
- Details of adjustments, if any made to transfer prices to align them with the arm's length prices
- Any other information, data or document relevant to determine the arm's length price

The aforesaid information shall be supported by authentic documentation, including:

- Official publications / reports / databases / studies
- Market research studies / technical publications
- Price publications including stock exchange and commodity market quotations
- Published accounts / financial statements relating to business affairs of associated enterprises
- Agreements / contracts with associated enterprises or unrelated parties
- Letters and other correspondence documenting any terms negotiated between the taxpayer and the associated enterprises
- Documents issued in connection with various transactions under accounting practices followed

Annexure 2

Action Plan 13 – TP documentation – Master File

Organisational structure

- Chart illustrating the MNE's legal and ownership structure and geographical location of operating entities.

Description of MNE's business(es)

- General written description of the MNE's business including:
  - Important drivers of business profit;
  - A description of the supply chain for the group's five largest products and / or service offerings by turnover plus any other products and/or services amounting to more than

5 per cent of group turnover. The required description could take the form of a chart or a diagram;

- A list and brief description of important service arrangements between members of the MNE group, other than research and development (R&D) services, including a description of the capabilities of the principal locations providing important services and transfer pricing policies for allocating services costs and determining prices to be paid for intra-group services;
- A description of the main geographic markets for the group's products and services that are referred to in the second bullet point above;
- A brief written functional analysis describing the principal contributions to value creation by individual entities within the group, i.e. key functions performed, important risks assumed, and important assets used;
- A description of important business restructuring transactions, acquisitions and divestitures occurring during the fiscal year.

MNE's intangibles (as defined in Chapter VI of these Guidelines)

- A general description of the MNE's overall strategy for the development, ownership and exploitation of intangibles, including location of principal R&D facilities and location of R&D management.
- A list of intangibles or groups of intangibles of the MNE group that are important for transfer pricing purposes and which entities legally own them.
- A list of important agreements among identified associated enterprises related to intangibles, including cost contribution arrangements, principal research service agreements and licence agreements.
- A general description of the group's transfer pricing policies related to R&D and intangibles.
- A general description of any important transfers of interests in intangibles among associated enterprises during the fiscal year concerned, including the entities, countries, and compensation involved.

MNE's inter company financial activities

- A general description of how the group is financed, including important financing arrangements with unrelated lenders.
- The identification of any members of the MNE group that provide a central financing function for the group, including the country under whose laws the entity is organised and the place of effective management of such entities.
- A general description of the MNE's general transfer pricing policies related to financing arrangements between associated enterprises.

MNE's financial and tax positions

- The MNE's annual consolidated financial statement for the fiscal year concerned if otherwise prepared for financial reporting, regulatory, internal management, tax or other purposes.
- A list and brief description of the MNE group's existing unilateral advance pricing agreements (APAs) and other tax rulings relating to the allocation of income among countries.

Annexure 3

Action Plan 13 – TP documentation – Local File

The following information should be included in the Local file:

Local entity

- Description of the management structure of the local entity
- Local organisation chart
- Description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices
- Description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year
- Key competitors

Controlled transactions - For each material category of controlled transactions:

- Description of the material controlled transactions
- Amount of intra-group payments and receipts for each category of controlled transactions, broken down by tax jurisdiction of the foreign payor or recipient
- Identification of associated enterprises involved in each category of controlled transactions, and the relationship amongst them
- Copies of all material inter-company agreements concluded by the local entity
- Detailed comparability and functional analysis of the taxpayer and relevant associated enterprises
- Indication of the most appropriate transfer pricing method and the reasons for selecting that method
- Indication of which associated enterprise is selected as the tested party and an explanation of reasons for selection
- Summary of the important assumptions made in applying the transfer pricing methodology
- Explanation of the reasons for performing a multi-year analysis, if relevant
- List and description of selected comparable uncontrolled transactions (internal or external), if any, and information on relevant financial indicators for independent enterprises relied on in the transfer pricing analysis, including a description of the comparable search methodology and the source of such information
- Description of any comparability adjustments performed
- Description of the reasons for concluding that relevant transactions were priced on an arm's length basis based on the application of the selected transfer pricing method

- Summary of financial information used in applying the transfer pricing methodology
- Copy of existing unilateral and bilateral / multilateral APAs and other tax rulings to which the local tax jurisdiction is not a party and which are related to controlled transactions described above

Financial information

- Annual local entity financial accounts for the fiscal year concerned, audited or unaudited statements, as the case may be
- Information and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements
- Summary schedules of relevant financial data for comparables used in the analysis and the sources from which that data was obtained

Annexure 4

CbCR – OECD recommended template

CbyC Template –Page 1									
Country	**Revenue**			**Profit (loss) before income tax**	**Income tax paid (on a cash basis)**	**Income tax accrued – current year**	**Stated capital and accumulated earnings**	**Number of employees**	**Tangible assets other than cash and cash equivalents**
	Related party	**Unrelated party**	**Total**						
Country A	X	X	X	X	X	X	X	X	X
Country B	X	X	X	X	X	X	X	X	X

CbyC Template –Page 2 (onwards)														
			Activities											
Country	Constituent entities resident in country	Country of organisation or incorporation in different from country of residence	R&D	Purchasing & procurement	Manufacturing & production	Sales, marketing & distribution	Administrative, management & support services	External service business	Regulated financial services	Insurance	Holding company	Dormant	Other
Country A	Entity A	Country B	✓				✓						
	Entity B			✓		✓				✓			


CA Anish Thacker & CA Dharini Minawala

Reference to the Transfer Pricing Officer, Dispute Resolution Panel and Safe Harbour Rules

Introduction

In this article, we have been asked to deal with topics that are largely procedural in nature but which do raise some interesting issues. The scope of these subjects is quite wide and keeping page constraints in mind, this article makes an attempt to raise relevant issues and acquaint the readers with these.

When can the Assessing Officer (AO) refer to Transfer Pricing Officer (TPO)

Under Section 92C(3) of the Income-tax Act, 1961 (Act), the power to determine the ALP in an international transaction or specified domestic transaction (SDT) has been conferred upon the AO. However, Section 92CA(1) of the Act enables the AO (with previous approval of Principal Commissioner of Income-tax or Commissioner of Income-tax (CIT)) to make a reference to the Transfer Pricing Officer (TPO) for computation of arm's length price (ALP) in relation to assessee's international transaction or SDT, in cases where he considers it necessary or expedient to do so. This section should be read in conjunction with Instructions issued by the Central Board of Direct Taxes (CBDT) to bring in procedural uniformity.

CBDT Instruction No. 3 of 2016 dated 10th March, 2016 (New Guidelines)

Background

The CBDT, soon after the enactment of the Transfer Pricing provisions, had issued Instruction No. 3 of 2003, which directed mandatory reference to TPO where the value of international transactions is INR 5 crore or more. Further, Instruction No.6 of 2014 issued by the CBDT provided that the selection of cases was to be based on an automated process called the Computer Assisted Scrutiny Selection (CASS). However, this Instruction required mandatory reference to TPO, if in the earlier years, there was an adjustment to the ALP determined by the assessee (TP adjustment), amounting to INR 10 crore or more. In view of various legislative, procedural and structural changes carried out over the last few years, Instruction No. 3 of 2003 was replaced by Instruction No. 15 of 2015, which was again replaced by Instruction No. 3 of 2016 issued on 10th March, 2016.

Circumstances under which the AO should refer the cases to the TPO

The circumstances under which the AO can make a reference to the TPO has been laid down in Clause 3.2 and Clause 3.3 of the New Guidelines.

Clause 3.2: Selection of case for scrutiny basis Transfer Pricing (TP) risk parameters

Clause 3.2 of the New Guidelines require that all cases selected for scrutiny on the basis of "TP risk parameters" with respect to international transactions and SDTs, either under the CASS system or under compulsory manual selection system, should be mandatorily referred to the TPO by the AO after obtaining necessary approval from the CIT. While the "TP risk parameters" are not defined in the New Guidelines, they mention that whether a case has been selected for scrutiny based on TP risk parameter, can be identified from a perusal of the records available with the AO.

Clause 3.3: Selection of case for scrutiny basis other reasons

Clause 3.3 of the New Guidelines provide that cases selected for scrutiny for reasons other than TP risk parameters but also having international transactions or specified domestic transactions, shall be referred to TPOs only in the following circumstances:

(a) Where the AO becomes aware of assessee's international transactions or SDTs or both but:
   - The assessee has not filed Form 3CEB; or
   - The assessee has not disclosed the said transactions in its Form 3CEB

(b) Where there has been a TP adjustment of INR 10 crore or more in an earlier assessment year and the same is:
   - Upheld by the appellate authorities; or
   - Pending to be heard by the appellate authorities

(c) Where search and seizure or survey operations have been carried out under the provisions of the Act and the Investigation Wing or the AO has made some findings in relation to TP issues.

Mandatory Reference under Clause 3.5

In addition to these reasons, Clause 3.5 of the New Guidelines states that where an earlier assessment year's case involves TP adjustment and such adjustment has been fully or partially set-aside by the ITAT, High Court or Supreme Court, then such assessee's case shall invariably be referred to the TPO for determination of ALP.

AO to record his satisfaction

Prior to making reference to TPO under Clause 3.2 and Clause 3.3 under the New Guidelines, Clause 3.4 requires that the AO should record his satisfaction that there is an income or a potential of an income arising and/or being affected on determination of the ALP of an international transaction or SDT in respect of transactions having the following situations:

(a) Where the AO becomes aware of assessee's international transactions or SDTs or both but:
   - The assessee has not filed Form 3CEB; or
   - The assessee has not disclosed the said transactions in its Form 3CEB

(b) Where the assessee has declared the international transactions or specified domestic transactions in Form 3CEB but has made certain qualifying remarks to the effect that the said transactions are not international transactions or SDTs or they do not impact the income of the assessee.

AO to provide an opportunity of being heard to the assessee before recording his satisfaction or otherwise

Clause 3.4 further states that the AO must provide an opportunity of being heard to the assessee before recording his satisfaction or otherwise. Where an assessee objects to the proposed reference, the AO is required to consider the assessee's objections and pass a speaking order. Where the AO decides to refer the case to the TPO, he should make a reference after obtaining the approval of the Principal CIT or CIT.

Reference to TPO

The letter issued by the AO to the TPO making the reference should explicitly mention all the relevant international transactions or SDTs except those about which the AO has decided not to make a referral to the TPO.

Operational guidance to TPO

The TPO is required to determine the ALP of transactions referred to him by the AO. Additionally, in view of Section 92CA(2A) and (2B) of the Act, the TPO is also empowered to examine any other international transactions that come to his notice during the proceedings. While the primary roles and responsibilities of TPOs remain the same, the New Guidance provides that the TPO's order should contain the following minimum details as these would be subjected to judicial scrutiny in case of further appeals/objections.

- Comparable data used for the purpose of the ALP computation
- Application of most appropriate method
- Reasons for arriving at a certain ALP

Further, working papers forming part of a TP assessment proceeding should be made available to the jurisdictional AO for his records and use at subsequent stages of appellate or penal proceedings. As per the New Guidelines, the jurisdictional Commissioner having oversight on TP assessments should assign a limited number of important and complex cases, not exceeding 50, to senior TPOs who are of the rank of Additional/ Joint Commissioner.

In addition to the above, the TPO would be responsible for carrying out compliance audits of Advance Pricing Agreements (APA) and also cases where the assessee has opted for Indian Safe Harbour provisions

The New Guidelines also provide that each TPO should record all the events connected with the whole process of determination of the ALP in the prescribed format, which will serve as an important database for future action and also help in bringing about uniformity in the determination of the ALP in identical or substantially identical cases. Such data maintained by each TPO should be consolidated into one report after the end of each TP assessment cycle under the jurisdiction of the concerned Commissioner

Binding nature of ALP determined by TPO on the AO

As per provisions of Section 92CA(4) of the Act, where reference is made to the TPO for determination of ALP, the AO shall compute the total income of the assessee in conformity with the ALP so determined by the TPO. The words 'in conformity' have been substituted by the Finance Act, 2007 in place of 'having regard to'. This amendment clearly reflects the binding nature of the ALP determined by the TPO on the AO.

Can the AO determine ALP himself?

In light of the above, question arises as to whether AO can determine ALP himself. Under Section 92C (3) of the Act, the power to determine the ALP in an international transaction or SDT has been conferred upon the AO. Having said that, Clause 3.7 of the New Guidelines explicitly clarifies that although such power has been vested with the AO, for administrating the transfer pricing regime in an efficient manner, AO should not determine ALP where reference is not made to the TPO.

In such cases, the AO must record in assessment order issued under section 143(3) of the Act that the transfer pricing issue has not been examined at all in view of the Instruction issued by the CBDT. However, in such cases, the AO must record in the body of the assessment order that due to the Board's Instruction on this matter, the transfer pricing issue has not been examined at all.

It is a settled position that CBDT Instructions are binding on the tax authorities. Accordingly, the AOs and TPOs are bound by the functions laid down in the CBDT Instruction 3/2016 and where the AO determines ALP himself, the same would be considered ultra vires this Instruction. Such explicit demarcation of functions should reduce litigation arising in respect of the role of an AO and a TPO in a TP assessment. Having said that, one cannot say with complete assurance if this Instruction would also be helpful in putting to rest, litigation in respect of references made to TPO prior to issuance of Instruction 3/ 2016. Controversy is already surfacing in courts on this subject matter.

We have discussed below, in brief, two recent judicial precedents where the assessee objected the TP adjustment by placing reliance on Instruction 3/2016 specifically clause 3.4 whereby the AO is obligated to grant an opportunity of hearing to the assessee before making a reference to the TPO.

Recently, Delhi ITAT in the case of *Nikon India Private Limited vs. DCIT (ITA No. 6314/Del/2015)* categorically held that CBDT Instruction 3/2016 has only prospective application. In this regard, Delhi ITAT has observed that instructions to the Officers given by the Board setting up a procedure for implementation of certain provisions cannot assume the character of a legislative provision so as to toy with the possibility of applying the same retrospectively. In this case, the assessee contended that though a reference was made to the TPO, the same was not in respect of advertising marketing and promotion expenses (AMP) and hence, TP adjustment in respect of AMP was ultra vires the powers of the TPO. In this regard, it is relevant to note that before dealing with the issue of retrospective applicability of Instruction 3/2016, the Delhi ITAT observed that given it is nowhere laid down that the power of the TPO to determine the ALP of an international transaction is restricted to those referred by the AO alone, which is in line with statutory mandate of Section 92CA (2A) and 92CA (2B) of the Act.

However, subsequent to this ruling, Delhi High Court in the case of *Indorama Synthetics (India) Limited vs. the Additional CIT (W.P.(C) 6422/2013* & *CM No. 14002/2013 (Stay) W.P.(C) 4558/2014 and W.P.(C) 12072/2015)*, has observed that Instruction 3/2016 clarifies the correct legal position and cannot be construed as not applying to the facts on hand. The Court has further observed that since it is a procedural aspect and it is intended to the benefit of to the assessee, it requires to be applied even in the present case where a reference was earlier made by the AO to the TPO on 31st March, 2013 and thereafter.

Prior to Instruction 3/2016, explicit provisions did not exist which required an AO to grant the assessee an opportunity of hearing before making a reference to the TPO. In light of the above judicial precedents, possibility exist that several assessees would strive to seek the benefit of opportunity of hearing prior to reference (even in the impending cases) by contending that provisions of Instruction 3/2016 are applicable retrospectively.

Procedure to be followed in case of information obtained under section 133(6) is used

Another noteworthy aspect of the procedure followed in TP assessment relates to the powers exercised by the TPO under Section 133(6) of the Act, usually, to seek information from companies which, in their opinion, could be used as a comparable for determining the ALP of its assessee's international transactions.

It is a settled position that where tax authority proposes to make adjustments to an assessee's income basis information received by invoking provisions of Section 133(6), such information should be shared with the assessee so as to give him a fair opportunity to present his case.

Further, in a recent ruling in the case of *Cashedge India Private Limited vs. The Deputy Commissioner of Income-tax W.P.(C) 3628/2016 & CM No. 15535/2016* (stay), the Delhi High Court has also recognised an assessee's right to even cross-examine authorised personnel of companies where the TPO proposes to use such company's data as a comparable. In this case, information of this comparable company was not available in the public domain.

This ruling supports the fact that natural justice should be extended by the tax authorities to the assessee. Accordingly, where the TPO proposes to use a comparable by invoking section 133(6), the assessee has the following rights:

- Ask the TPO to share such information; and
- Cross-examine the authorised personnel of such comparable company so as to better understand its relevance to the assessee's own case.

Appeal before Dispute Resolution Panel (DRP) and CIT (Appeals)

In the Finance Act, 2009, an alternative dispute resolution mechanism viz.; DRP was introduced by insertion of section 144C with the following two objectives:

- Speedy disposal of disputes (particularly involving high amount of disputed tax demand); and
- It was observed that AOs and TPOs tend to take a conservative view while determining the ALP. DRP mechanism was introduced with an intention to rationalise such approach

"Dispute Resolution Panel" means a collegium comprising of three [Principal Commissioners or] Commissioners of Income-tax constituted by the CBDT for the purpose.

The key areas of distinction between the two alternatives are tabulated below:

Particulars	Objections before the DRP	Appeal before the CIT(A)
Eligible cases	• Cases where TP Adjustments are proposed by the AO • Assessment of foreign companies	Appealable orders as per section 246 of the Act
When can it be referred	Post issue of draft order under section 144C (1) of the Act	Post issue of final order under section 143(3) read with 144C of the Act
Payment of tax demand	To be made post issue of final order which is issued post DRP directions.	Before the matter is heard by the CIT(A) within 30 days of receipt of Notice of demand.
Time limit for passing the order	Nine months from the end of the month in which the draft order is forwarded to the assessee	Section 250(6A) provides that where it is possible, the CIT(A) may hear and decide such appeal within a period of one year from the end of the financial year in which appeal if filed before him
Can the assessee challenge the decision before the ITAT?	Yes	Yes
Can the AO challenge the decision before the ITAT?	No	Yes

Power of DRP to enhance variations

Section 144C(8) provides that DRP may confirm, reduce or enhance the variations proposed in the draft order of the Assessing Officer. In the case of *GE India Technology Centre Pvt. Ltd. vs. DRP and ACIT* [Writ Appeal No. 1010 of 2011 (T-IT)], the Karnataka High Court held that the power of DRP is restricted only to the issues raised in the draft assessment order and therefore it cannot enhance the variation proposed in the order as a result of any new issue which comes to the notice of the panel during the course of proceedings before it.

In the Memorandum to the Finance Bill, 2016, it has been observed that this is not in accordance with the legislative intent. Accordingly, Finance Act, 2016 has inserted an explanation in the provisions of section 144C to clarify that the power of the DRP to enhance the variation shall include and shall always be deemed to have included the power to consider any matter arising out of the assessment proceedings relating to the draft assessment order. This power to consider any issue would be irrespective of the fact whether such matter was raised by the eligible assessee or not. This amendment is effective retrospectively from 1st April, 2009 and will accordingly apply to assessment year 2009-10 and subsequent assessment years.

The advantages from preferring objections before the DRP are:

- *Deferment of payment of disputed tax demand.*

  Where objections are filed before the DRP, the tax is payable only after issuance of final order; which it can extend up to 12 months after the issue of draft order (including 30 days for filing the objections, 30 days for issuing final order post issue of DRP directions and 30 days for payment of tax demand).

  Having said that, recently, the CBDT has issued modification to the Instruction 1914/1996 whereby the AO has been empowered to grant stay of demand till disposal of appeal by CIT(A), upon payment of 15% of disputed demand except where the assessing officer is of the view that the nature of addition resulting in the disputed demand is such that payment of lump sum amount higher/lower than 15% is warranted (for instance, where the same issue is a covered matter in case of assessee or Supreme Court/High Court judgment squarely applies). So one of the key factors i.e., disputed tax demand has reduced from 100% to 15%.

- *Fast tracking of the litigation in view of timeline of nine months for disposal of objections.*

  With a definite timeline of nine months, the DRP certainly aids in fast tracking of the litigation. Where the assessee is still aggrieved, he has the option to prefer an appeal before the ITAT. However, unlike the DRP proceedings, there is no definite timeline in which such appeals before the ITAT are required to be disposed, unless it involves stay of tax demand.

Is DRP an alternative in true sense of the term?

The term "alternative dispute redressal mechanism" gives the idea of a process which would be in complete replacement of the conventional process of litigation beginning from AO/TPO, followed by CIT(A) and then ITAT (leaving aside the further process of appeal to HC and SC for the time-being).

Although the DRP process begins as an alternative, somewhere along this process, it once again merges with the conventional approach and the matters eventually lay in appeal before the ITAT. The legislature has tried to partially correct this by withdrawing the AO's right to appeal to the ITAT against the directions of the DRP which impedes the speedy disposal of matters. This amendment has been brought in by Finance Act, 2016. Although, this should give an essence of finality to the DRP directions as far the tax authorities are concerned, question arises if such a power vested upon the DRP would be exercised by them objectively or conservatively?

Safe harbour rules notified till date in respect of international transactions

In yet another attempt to remedy the growing litigation in transfer pricing, on 18th September, 2013, the CBDT issued the final safe harbour rules in respect of international transactions (Rule 10TA to Rule 10TG of the Income-tax Rules, 1962).

The Rules provide definition for various key terms used. The transfer price contained in the safe harbour rules shall be applicable for five years beginning from AY 2013-14. The Rules, optional for an assessee, contain the conditions and circumstances under which the norms/margins would be accepted by the Tax Authority and the related compliance obligations. The assessee has flexibility in electing the years to be governed by the safe harbour rules within the five year period.

Assessees opting for the safe harbour shall be required to maintain the mandatory prescribed transfer pricing documentation and also file the Accountant's report in Form 3CEB.

Rule 10TD: Threshold and Safe Harbour margin

The transfer price declared by an eligible assessee shall be accepted by the Tax Authorities for the below mentioned international transactions (eligible international transactions) subject to the ceilings/ circumstances stated as under:

Eligible International Transaction	Threshold limit prescribed for transaction value	Safe harbour margin
Provision of software development services other than contract R&D with insignificant risks	Up to INR 500 crore	20% or more on total operating costs
	Above INR 500 crore	22% or more on total operating costs
Provision of information technology enabled services (ITES) other than contract R&D with insignificant risks	Up to INR 500 crore	20% or more on total operating costs
	Above INR 500 crore	22% or more on total operating costs
Provision of information technology enabled services being knowledge processes outsourcing services other than contract R&D with insignificant risks	No limit	25% or more on total operating costs
Advancing of intra-group loan to a non-resident wholly owned subsidiary	Up to INR 5 crore	The interest rate declared in relation to the international transaction, is equal to or greater than the base rate of State Bank of India (SBI) as of 30th June of the relevant previous year plus 150 basis points
Advancing of intra-group loan to a non-resident wholly owned subsidiary	Above INR 5 crore	The Interest rate declared in relation to the international transaction, is equal to or greater than the base rate of State Bank of India (SBI) as of 30th June of the relevant previous year plus 300 basis points
Providing explicit corporate guarantee to wholly owned subsidiary	Up to INR 100 crore	The commission or fee declared in relation to the international transaction is at the rate of 2% or more per annum on the amount guaranteed
	Above INR 1 billion, provided the wholly owned subsidiary has been rated to be of adequate to highest safety by a rating agency registered with SEBI	The commission or fee declared in relation to the international transaction is at the rate of 1.75% or more per annum on the amount guaranteed

Eligible International Transaction	Threshold limit prescribed for transaction value	Safe harbour margin
Provision of specified contract R&D services wholly or partly relating to software development with insignificant risks	No limit	30% or more on total operating costs
Provision of contract R&D services wholly or partly relating to generic pharmaceutical drugs with insignificant risks	No limit	29% or more on total operating costs
Manufacture and export of core auto components	No limit	12% or more on total operating costs
Manufacture and export of non-core auto components where 90% or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer (OEM) sales	No limit	8.5% or more on total operating costs

Insignificant risk to be assumed by assessee in case of certain eligible transactions (Rule 10TB)

The Rules has laid down the conditions/circumstances in which it can be said that the assessee has assumed insignificant risks in relation to relevant international transactions.

- The foreign principal or its Associated Enterprises (AEs) to perform economically significant functions and provide capital and other economically significant assets.
- The assessee is expected to work under the supervision of the foreign principal or its AEs who have capability to control or supervise the work of the Indian entity.
- The assessee should not assume any economically significant risk.

Rule 10TE: Filing of Form 3CEFA

An assessee who has entered into an eligible international transaction and who wishes to exercise the option to be governed by the safe harbour rules is required to file a specified form (Form 3CEFA) and furnish it before the due date for filing the tax return for:

- The relevant financial year, in case the option is exercised only for that financial year or;
- The first of the financial years, in case the option is exercised for more than one financial year.

The option for safe harbour validly exercised shall continue to remain in force for the period specified in Form 3CEFA or a period of five years, whichever is less.

Rule 10TE: Power of AO/TPO to verify eligibility and prescribed timelines

The Rules provide for the power and procedure for the AO/TPO to verify eligibility of the assessee and the international transaction in terms of the safe harbour rules. Where the TPO passes an order challenging the eligibility of either of the two, assessee can appeal such order before the CIT. Timelines for this process are as below:

Action	Timeline
Reference by AO to TPO to determine eligibility of assessee or international transaction or both for purposes of the safe harbour	Two months from the end of the month in which Form 3CEFA is received by AO
TPO to pass an order after determining validity or otherwise of the option exercised by the assessee	Two months from the end of the month in which reference from AO is received
Commissioner to pass an order with respect to the validity or otherwise of the option exercised by the assessee	Two months from the end of the month in which the objections filed by the assessee are received

If the AO/TPO or the Commissioner does not make a reference or pass an order, as the case may be, within the time specified above, then the option of the safe harbour exercised by the assessee shall be treated as valid

Where an assessee's transfer price is accepted by the Tax Authority under the safe harbour rules, the assessee shall not be entitled to invoke the mutual agreement procedure (MAP) under an applicable tax treaty (Rule 10TG).

Rule 10TF: Ineligible assessee

The safe harbour provisions shall not be applicable to an assessee who has entered into an eligible international transaction with an AE located in a country or territory notified under Section 94A of the Act, or in a no-tax or low-tax country/territory (maximum rate of income tax is less than 15% for the AE).

Safe harbour rules notified till date in respect of SDTs

The CBDT on 4th February, 2015 has issued safe harbour rules in respect of SDTs (Rule 10TH to Rule 10THD of the Income-tax Rules, 1962). The validity of these Rules is not limited to five years from the date of its issue. However, the benefits of these Rules have been extended to limited assessee defined as eligible under Rule 10THA viz:

- A Government company engaged in the business of generation, supply, transmission or distribution of electricity; or
- A co-operative society engaged in the business of procuring and marketing milk and milk products

Is safe harbour really a game-changer?

While the introduction of safe harbour rules was yet another attempt of the legislation to reduce litigation, the response to this mechanism has not been as significant as was apprehended at the time of its introduction. Some of the key reasons for the same could be identified as under:

i. The benefits have been extended to limited sectors of the industry.

ii. The safe harbour margins appear to be higher than the margins agreed between them and the AEs to make them commercially viable. This is further complicated by prescribing higher margins for companies with higher turnover — a relationship not empirically proven. These margins are likely to be challenged in the other country which is party to the transaction and can lead to double taxation.

iii. Definitions of certain terms could be further clarified. This is especially relevant for IT, ITES and R&D related services.

iv. Restricting the operation of 'mutual agreement procedure' (MAP) for a taxpayer opting for the safe harbour could act as a serious hurdle.

Given that the five year period of the current safe harbour rules expires in AY 2017-18, talks are already on-going for launching second phase of these rules. The taxpayers certainly look forward to a more evolved version of safe harbour rules which would be more attuned to the dynamics of global economy and hence, more lucrative.

Alpana Saksena, Chief Tax Advisor – Oracle India

Advance Pricing Agreement and Mutual Agreement Procedure

"Today, it takes more brains and effort to make out the income-tax form than it does to make the income."
— Alfred E. Neuman

The ever-growing participation of MNCs in the economic activities of the host country has brought new and complex issues in its wake, emerging from transactions entered into between two or more enterprises belonging to the same multinational group. India is no stranger to the current global trend which is witnessing proactive taxing authorities rising in unision to protect their revenue base by substantially increasing the pace and sophistication of tax audits, including those focused on transfer pricing. The 'transfer' of profits by these MNCs by manipulating intragroup "prices' has now made 'Transfer Pricing" a throbbing pulse denoting the economic well-being or ill-health of any nation.

Transfer Pricing has emerged as one of the largest contributor to the burgeoning litigation overload as the global taxpaying community continues to grapple with turbulent times rife with uncertainty and multiple tax authorities in the face of heightened audit activity, a deep intrusive scrutiny of global intercompany transactions and a strict regulatory environment. Tax authorities on their part have brought in their collective global might to the table to protect their revenue turf and stall any base erosion or profit split as they devise ways to augment their tax bases. The number of pending income tax disputes of foreign companies operating in India and the revenue involved in such cases has plagued both tax authorities and taxpayers as they strain to navigate through complex legislation and grapple with uncertain tax positions.

Advance Pricing Agreement – The Evolution

APAs have been an important part of the transfer pricing landscape since the mid-1990s operating for over a decade in countries such as U.S. and Japan. With competing economies such as China and other Asian countries having already introduced this programme several years ago, India's entry in the APA club was long overdue.

Japan was a torch bearer in the APA marathon, and its flagship publication titled *'Guidance on Calculation of Arm's Length Prices'* (referred to as 1987 Directive), on April 24, 1987, the objective being "*.... to ensure the proper and smooth enforcement of transfer pricing legislation by giving administrative confirmation as to the most rational methods of calculation of arm's length prices for corporations*" laid the groundwork for the programme to take off.

As the concept gathered steam, the US Treasury Department published a white paper titled in

1988"A Study of Intercompany Pricing" and eventually launched the APA Programme in 1991 scoring a first with a bilateral APA with 'Apple Computer' between U.S. and Australia.

The Japanese and US tryst with the programme in the 1990s drew widespread acclaim with countries hasting to replicate the experience and soon the APA program surfaced in Canada, Australia, UK, Belgium and France. The OECD entered the fray with a set of APA Guidelines in 1999 followed by South American and Asian countries - China, Korea, Venezuela, Mexico and many more.

While Japan and USA, blazed the trail by setting up mature APA regimes, and have, till date, signed the most number of APAs compared to other countries, the rising tide of countries joining the APA bandwagon are a tribute to the increasingly popularity of APAs as one of the preferred methods to foster co-operation between the taxpayers and tax authorities and stem the tide of burgeoning transfer pricing disputes.

The Indian APA Programme

The march of MNCs to India was fueled when India opened its doors to the world by trading its restrictive and cautious approach in matters of foreign exchange and capital import with liberal investment friendly fiscal policies. International business pursued international investment followed naturally by enactment of laws - the transfer pricing regulations - to prevent shifting out of profits by MNCs. However, soon enough, aggressive regulatory positions spawned huge litigation which reached humungous proportions as the number of pending income tax disputes of foreign companies operating in India and the revenue involved in such cases grew in a Malthusian way and created depressing uncertainties for both tax administration and taxpayers alike.

In this backdrop the announcement of the APA programme, came like a breath of fresh air, affording the much needed succour and relief to the international taxpaying community weary of challenges presented by aggressive regulatory positions and chronic litigation and desperate for sustainable resolution strategies in a hugely litigious system..

On 16th March 2012 the then India's Finance Minister, in his budget address to the nation announced:

"In a globalised economy with expanding cross-border production chains and growing trade within entities of the same group, Advance Pricing Agreement (APA) can significantly bring down tax litigation and provide tax certainty to foreign investors. Though, the provision for APA has been included in the DTC Bill, 2010, I propose to bring forward its implementation by introducing it in the Finance Bill, 2012."

With this announcement India formally entered a new era in transfer pricing with the introduction of the Advance Pricing Agreement program and a viable controversy management alternative was born amidst optimism that principled negotiations with the Indian tax authorities in a co-operative and harmonious atmosphere would replace the present adversarial environment, free taxpayers of repeated audit and crippling above all mitigate economic double taxation.

Advance Pricing Agreement – Basic Provisions

APA is an agreement between the tax authorities and the taxpayer to determine in 'advance' the most appropriate Arm's Length Price (ALP) for intercompany international transactions.

The basic legislative provisions of the Indian APA program prescribe that a Unilateral / Bilateral / Multilateral APA can be entered into with the Central Board of direct Taxes for a period of up to 5 consecutive years, with an option of renewing the APA for another 5 years.

The APA program also provides flexibility in determining the Arm's Length Price which can be determined either by the most appropriate method out of the six methods prescribed in the Income Tax Act or by any other method suited for the purpose.

The taxpayer can apply for an APA by applying for a '*Pre-filing*' consultation (which was mandatory till 2014 and is now an optional) or can elect to directly file an APA application for either existing / old / ongoing or new International transactions. When filing for an existing transaction the APA application is required to be filed by March 31 of any year for covering the ongoing / old transactions commencing on the 1st April of the immediately succeeding Financial year – which effectively means that the prefiling process (application and prefiling consultations) should be completed well before this if the March 31st deadline is to be met for filing an APA application for existing transactions.

In case of new international transactions and APA application can be filed any time during the previous year but before the new transaction is entered into. An applicant can withdraw the APA application at any stage, before finalisation of the terms or signing of the APA.

Once an APA is entered into, the taxpayer would not be required to maintain detailed annual documentation to support its transfer prices and would not be required to undergo Transfer Pricing audits by the tax authorities for the covered transactions. However, the taxpayer would be required to file a compliance report which will be followed by annual compliance audit by the Transfer Pricing Officer (TPO). The compliance audit is expected to be much simpler than the regular TP audit.

With the announcement in 2014 of the much awaited Rollback Rules the APA programme aligned itself once again with global best practices and paved the path for resolving transfer pricing issues and achieving certainty for a number of past and future years in a single process. These Roll back rules provide an option to the taxpayer to "Rollback" an agreed and negotiated position on pricing of an international transaction reached under the advance pricing arrangement and can be applied to a similar transaction for up to four years in the past commencing from the immediately preceding financial year when the APA was filed. To illustrate, if an APA application was filed on March 31st 2016, the five forward years for which the APA will be signed would be Financial Years ending 2017 through Financial Year ending 2021 and the Rollback years will be Financial Years ending 2016, 2015, 2014 and 2013.

The key conditions prescribed for Rollback require the international transaction, for which the Roll back is applied, to be the same as the international transaction which is the subject matter of APA. It is also a mandatory requirement that the return of income for the relevant Rollback year should have been furnished by the applicant before the due date of filing return under Section 139(1) of the Income Tax Act, 1961. The rules also require that the report in respect of the international transactions (Form 3CEB) should have been furnished in accordance with Section 92E of the Income-tax Act, 1961.

No Rollback will be available in case the international transaction has been subject matter of an appeal before the Income Tax Appellate Tribunal (ITAT) and the ITAT has passed an order disposing of such appeal before signing of the APA. Rollback is also not applicable if the application of the rollback has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year.

Areas of Dispute where an APA could be useful

The Indian Transfer Pricing Audits have spawned disputes around each and every conceivable area of business and International transactions, however some international transactions can be classified as "favourites' under the APA programme. They are:

- Captive intra-group services (where the parent entity engages or contracts with its Indian subsidiary to perform certain designated services for the group entities (typically software development / business support services/ call centre functions) for which the parent provides a fixed return to its captive subsidiary in a risk insulated environment)

- Contract manufacturing
- Distribution of goods (Limited risk distributors)
- Royalty payments for use of intellectual property
- Business restructuring transactions
- Management cross charges
- Financial transactions (inter-company loans and guarantees)

It may be important to note that APA is applicable only for those 'International transactions' for which the APA has been applied *('covered transactions')*. In case there are some transactions for which an APA has not been applied (hence are not in the 'covered' category) then they could be picked up for regular transfer pricing scrutiny by the Transfer Pricing Officer.

Success of APA in India

The APA programme in India commenced with immense willingness on part of the APA office to adopt a non-adversarial posture with transparency and objectivity with an aim to boost taxpayer confidence in the programme. Companies navigating the APA process would have noticed how the APA teams strove to create a collaborative platform to transform the history of adversarial relationship with taxpayers to a thriving partnership. Instances of remarkable patience and resilience demonstrated by the APA office are not unknown as they invested considerable time and effort to deliver mutually acceptable outcomes in record time. This was particularly noticeable in cases where the taxpayers responded accurately and quickly to the information document requests from the APA team (an integral part of the APA process) – no matter how complex the cases or how scarred and riddled it was with contentious litigation history. The success itself is visible from the tremendous interest the APA programme elicited from taxpayers with a record number of over 700 applications being filed since its inception in 2013 and 100 APAs signed within 4 years of the programme.

Persuasive value of APAs

The CBDT had never discounted the persuasive power of APAs even when the Rollback Rules had not been announced. The FAQs and Guidance Notes on APAs issued by CBDT in 2013 clearly mention that though there are no provisions for Rollback of APAs, the persuasive value of the APAs over the audits for prior periods, cannot be completely ruled out. Now we have had the occasion to see these words come true.

The Income Tax Appellate Tribunal, Delhi, pronounced an important ruling on April 25th 2016 in the case of *Ranbaxy Laboratories Limited,* putting a stamp on CBDT's thought process stating in their judgement that an APA can have strong persuasive value by the way of providing guidance for resolving disputes beyond the rollback years, provided the nature of the international transactions and the functions, assets, and risks of the taxpayer and its associated enterprises' remain unchanged. The Indian Tribunal held that:

"The concept and the methodology laid down in the APA can have the guidance value for the revenue authorities for the purpose of comparability and analysis. The main intent of the APA is to protect the fair share of the revenue of the States in simple and efficient manner and to protect the tax base. ...Therefore, the agreement entered into by the CBDT with the assessee, which has considered all the aspects of the manner of termination of the ALP which are also similar for this year, should be given highest sanctity and therefore the mechanism suggested in that agreement should be necessarily followed in determining ALP of the transactions for this year."

Insight on various practical issues surrounding APA

Prefiling Consultations –The gateway

The Indian APA rules had, initially, made the prefiling consultations mandatory. The intention in doing so was to establish, on one hand, a screening mechanism to eliminate proposals where there could be significant challenges in achieving a mutually acceptable resolution and on the other to provide a collaborative platform to taxpayers to test waters and facilitate early exchange of ideas and expectations on various matters including complex, novel, and potentially contentious issues in an APA proposal without the necessity of entering the program formally. For the taxpayer, the pre-filing affords an opportunity to test waters, to gauge the receptivity of revenue to the APA proposal without having to file a formal one.

However, as the APA programme matured and taxpayers and the APA officers gained confidence in each other, it was decided to make the prefiling process optional, and at the discretion of the tax payer. Hence, prefiling consultation can now be used selectively by companies with complex business models and challenging and potentially litigious issues to proactively solicit the preliminary perception of the tax authorities on the proposed APA with a view to identifying issues that may require specific development and above all gauging the suitability of the application. Given that the prefiling conference can also be done anonymously, there would be tactical advantage in pursuing the prefiling conference without name to gauge revenue reaction to the proposed APA behind a screen of anonymity with no fear of adverse outcome should the taxpayer decide not to proceed with an APA. Moreover the insights gained from anonymous prefiling can be employed to evaluate corrective measures to reenergize a weak APA proposal, address potential barriers and make the APA proposal more robust or alternatively be prepared to face a conventional TP audit in a more informed way.

Preparation for filing and negotiations

The APA application being the first contact between the taxpayer and the tax authorities, could be leveraged upon by the taxpayer to make a favourable first impression by putting its best case forward at this stage. Though the preparatory process itself is reminiscent of the preparation of the Transfer Pricing documentation for traditional audit proceedings – it should not be confused with the replication of historically available TP studies. A critical component of the APA application and negotiations is the detailed "functional asset and risk analysis" (the FAR) which is literally the plinth and foundation on which the APA superstructure raised. The FAR analysis should address the functions performed, assets employed, and risks borne by each party to the covered International transactions along with a discussion of the relevant economic conditions and contractual terms. The FAR analysis forms the basis for the conclusions with regard to the economics of the transactions including the selection of the most appropriate method for arriving at the right Arm's length price.

For an effective APA process, it is critical that taxpayers present the facts and circumstances underlying the transactions covered by the proposed APA clearly, cogently, and comprehensively. The starting point for preparation of FAR should be to interview the key personnel of the company in detail for mapping the functions undertaken and the risks assumed by them during the course of their designated activities. It is also imperative to be mindful of the fact that articulation and reproduction of the data gathered should be done in a way as is comprehensible to an average mind unfamiliar the complex terminology (especially software terms) which is *lingua franca* of the business world. An effective way to establish credibility with the APA Office would be to anticipate the questions the APA teams could raise and address them proactively in the APA submissions in intelligible, unambiguous and plain diction along with accurate supporting analysis.

APA 'Site Visit'

Another important feature in the APA programme is the 'visit' of the APA team to the "site" or facility of the applicant company to understand first-hand the business operations of the company and gain insights into its day to day operations and functioning. The main purpose of the site visit is to see whether the field operations of the company conform to and are consistent with the functions declared in the APA application. It may augur well for applicants to make advance and meticulous preparations to showcase the business operations in an easy to understand fashion in order to facilitate the understanding of the APA team. One practical way to do this would be to prepare simple and effective power point presentations about the company's business operations and standard operating procedures and have them presented on the day of the site visit by respective business team leaders who should be hands resources for the job capable of explaining complexities in simple easy to understand words unembellished by complex business jargon.

APAs – Some key challenges

Time consuming

As India took its first fledgling steps to join the elite APA league, the birth pangs were keenly felt with the atmosphere rife with misgivings about the intention of the Government given India's track record with Transfer Pricing audits and doubts about the credibility of the programme itself. Though the angst was not unusual, given the experience of now mature APA regimes in their own teenage years, the programme limped a bit before gathering steam.

Though 100 APAs have been signed till date, there is a mixed bag of experience in terms of the speed of negotiations. What is seen today is that statistically, it takes from one to four years for tax authorities to negotiate an APA. Generally, time to resolution varies with the nature of the covered intercompany transactions, the complexity of the proposed transfer pricing method, and the personnel resources of both the tax authorities and the taxpayer. Some apprehensions persist especially about lack of sufficient trained officers and resources to handle the inflow of APA requests given the frequent transfers of APA teams resulting into huge backlogs and procedural delays. In some quarters it is felt that the information requests from the APA office are excessive and repetitive – the same thing being asked over and over again in different ways - all of which makes the process time-consuming and tedious. To this end considerable responsibility also rests on applicants to facilitate the final negotiations speedily by completing all data and information request received from the APA office. The applicants have the liberty to have a healthy dialogue with the APA teams should they have concerns about the information required from them. The current pace of business and fast evolving commercial environment requires the APA process to be expeditious if any "advance" feature is to remain in APAs given that it could travel well into the covered period and even drag the advance period to the penultimate year before an agreement is reached.

Absence of Article 9(2) in tax treaties – Resolution required

Article 9(2) of international tax treaties allows one country to give compensatory or corresponding adjustments to the taxpayers if there is double taxation. International consensus leans towards OECD view which advises contracting states to mitigate double taxation under Article 25 (MAP) absent the provision of "corresponding adjustment" in the form of Article 9(2),

However the Indian Government's strict and virtually non-negotiable stand of denying double tax relief in the absence of Article 9(2) in a treaty, stands in stark contrast to the postures adopted by most members of International community. India has gone a step further and declined to entertain bilateral APA requests from an applicant of treaty partner where Article 9(2) is absent. This approach, has denied the benefit of the APA programme to the MNCs of several key treaty partners – notable being Germany, Singapore, France and Italy. The recent renegotiation of the tax treaty with South Korea resulting in the introduction of the concept of "corresponding adjustment" through Article 9(2), has opened up the bilateral APA route with South Korea and would perhaps pave the way for similar renegotiation of treaties with other important trade partners. However, there is pressure on the Indian Government to unilaterally abrogate its rigid stand of insisting on Article 9(2) for providing corresponding adjustment and it remains to be seen whether India may consider changing its positons unilaterally.

Roll back challenges

There are certain practical issues in the application of the Rollback Rules – especially in the interpretation of the term 'an' international transaction. The key question here is – if in case the APA covers four transactions, while in the prior years (those covered by Roll back) three of those transactions did not exist and only one of those transactions was "same" as the one agreed in the APA – would it be possible to apply for a rollback in respect of that isolated transaction?

Further, the application of Rule 10MA(3)(i) of the Rollback Rules could also prove to be a bottleneck. This rule provides that if in consequence of an appeal, an ITAT has ruled in respect of International transactions (which are the subject matters of the APA) for any of the rollback years, before the signing of the APA, then the relevant fiscal year would be out of the ambit of the rollback provisions. This inevitably leads to the premise that a taxpayer desirous of availing the benefit of rollback for a year under appeal before the ITAT, should desist from pursuing the appeal with the Tribunal, lest a ruling arrives before the APA is concluded. But then in such a case how would a taxpayer seek immunity from the substantial tax demand, which the assessment order under appeal would have imposed? Would the ITAT stay the collection of such demand, without the taxpayer agreeing to appear in an early hearing of the appeal? Given these scenarios, much testing need to be done to see how Rollback will rise to such challenges posed by business dynamics without compromising the efficacy and popularity of the programme.

APAs in a BEPS world

India has been an active participant in the Base Erosion and Profit Shifting ("BEPS") Project of OECD, and not only helped set up the action plan but is committed to bringing in domestic legislative changes for implementing the various BEPS measures. Under BEPS, the global tax landscape for multinational companies is under fundamental reform, the principles of which have been substantially agreed by over 60 OECD Member States. One of the fundamental pillars of the BEPS project is to ensure that the global activities of companies are more transparent to tax authorities worldwide. As tax administrations acquire more powers and receive more information as a consequence of the BEPS initiatives, they are likely to use that power and information.

To illustrate – BEPS Action 13 calls for a three-tier approach to transfer pricing documentation (master file, local file, and country-by-country report) that will provide tax administrations with useful information to assess transfer pricing risks, including the disclosure of all unilateral/bilateral multilateral APAs. Such disclosure may lead to unintended complexities especially if a favorable unilateral APA in one country is perceived as unfavorable by the tax authority of another country on the grounds of tax base erosion.

Moreover as the BEPS action plans go live one by one, it is expected that differences in interpretation of OECD / BEPS guidelines and the interplay of each countries' domestic legislation with the various nuances of the BEPS Action plans could create an atmosphere rife for disputes especially in areas of Transfer Pricing. In anticipation OECD is already in an overdrive mode to encourage dispute resolution not only through MAPs but also dispute prevention through APAs. In this context Action Plan 14 of the BEPS Action plans is of particular interest as it contains best practice recommendations urging countries to implement bilateral advance pricing arrangement ("APA") programmes so as to proactively mitigate double taxation issues. All this ties up to India's recent move to renegotiate treaties to include Article 9(2) and remove the procedural blocks for bilateral and multilateral APAs.

In such circumstances and given that Unilateral APAs by their very nature do not eliminate or prevent double taxation, even though they may be faster to negotiate, the advantages of bilateral or multilateral agreements over unilateral agreements could be evaluated by MNCs to insulate themselves fully from the perils of double taxation. In fact it may not be unusual to witness a spate of APAs as MNCs build up a veritable scrap book of agreements to showcase before hawkish tax jurisdictions to persuade them and bring them on board on the premise that if they could clinch deals for similar transactions in other countries then their credentials could not be suspect.

Mutual Agreement Procedure (MAP)

The Mutual Agreement Procedure (MAP) is an alternative dispute resolution strategy available to a taxpayer for resolving disputes giving rise to double taxation. The authorisation to invoke MAP is found in the MAP Article 25 in the OECD Model Tax Convention and in all tax treaties. The MAP article enjoins the "competent authorities" (designated officers/representatives) from the Governments of the contracting States to interact with each other with the intent to resolve international tax disputes involving cases of double taxation arising out of inconsistencies in the interpretation and application of a treaty. Generally, the issues and instances giving rise to double taxation across the world and India in particular are adjustments arising from Transfer Pricing assessments, issues relating to existence of and attribution of Profits to the Permanent Establishment and characterization of income. Interestingly, in India, MAP can be initiated irrespective of the remedies provided by the domestic law be pursued alongside existing conventional dispute resolution mechanisms.

MAP – procedural guidelines

MAP needs to be initiated by the taxpayer who has borne the incidence of double taxation before the competent authority (CA) in the country of his residence. If initiated in India (and the occasion would be triggered if an adjustment is made to an Indian subsidiary's income located abroad by a foreign tax authority) the procedure commences with the filing of an application by an Indian resident in Form 34F. The Rules for dealing with the MAP, is prescribed in Rule 44G and 44H of the Income-tax Rules 1962, which provide procedural guidance in respect of initiation and implementation of MAP.

- The application should first be presented to the CA of the resident country who shall endeavor to resolve the dispute itself, failing which the CA may reach out to the contracting state for resolution by mutual agreement.
- The time limit prescribed for filing for MAP is mentioned in every treaty and is usually two to three years, from the date of receipt of the first notification of an action (a notice) which gives rise to taxation not in accordance with the tax treaty. Most of the Indian tax treaties (for example, treaties with countries like Australia, Belgium, Finland, US, Sweden, Switzerland) specify a time limit within which the application can be presented to the CA.
- Rule 44H further prescribes that any resolution arrived at under MAP is to be given effect by the tax officer within ninety days from the receipt of the same by the Chief Commissioner or Director General of Income-tax, if the taxpayer gives acceptance to the resolution taken under MAP and withdraws an appeal, if any, pending on the issue which was the subject matter for adjudication under MAP.
- There are no clear guidelines on the payment of tax demands when the MAP process has been initiated. However, the Indian and the US and UK competent authorities have entered into a memorandum of understanding (MoU) which provides that tax demand would be kept in suspension during the pendency of MAP. The suspension would be dependent upon various conditions, which include furnishing of a bank guarantee of an

amount equal to the amount of tax under dispute and interest accruing thereon as per the provisions of the Act.

Success of MAP in India

The history of MAP in India is largely the history of bilateral tax disputes between India and the US – the biggest trade partner of India. Since inception of the Transfer Pricing law in India, US multinationals had been subject to aggressive Transfer Pricing Audits beginning early 2004. The disputes mushroomed on a daily basis clogging the administrative arteries and creating an alarmingly litigation overload with no relief from double taxation in sight. Post a feeble attempt at resolution in 2010, when a handful of MAP cases were resolved between India and US, progress came to a virtual standstill given reported US concerns about strict approaches adopted by India, which in US's view made the Arms' length principle unworkable.

However, with the change of guard at the India and US Competent Authority level, feelers of collaborative approaches were exchanged between both the CAs as they worked hard to arrive at a consensus to tackle the intimidating inventory of MAP disputes. In what is popularly called a breakthrough development the collaborative discussions led to the signing of a *'Framework Agreement'* in January 2015 between India and US under the Mutual Agreement Procedure (MAP) provision of the India-US treaty. The target was to clear the pending stalemated inventory of 200 past transfer pricing disputes between the two countries in Information Technology (Software Development) Services (ITS) and Information Technology enabled Services (ITeS) segments. Since then and in consequence of the *'Framework Agreement'*, the MAP negotiations between India and US have alighted on better days leading to an amicable resolution of over 100 disputes till date. It is understood that in compliance with BEPS, India would soon be devising procedures and practices through legislative and administrative changes to enable speedy resolution of tax disputes through the MAP route.

Basis the success of the 'Framework Agreement' US threw open their doors to India for the bilateral APA programme in February 2016, thereby providing a shot in the arm to investor sentiment and paving the way for greater transfer pricing co-operation between the two countries. Since then several Bilateral APA applications have been filed and have been picked up for processing at the US end.

Epilogue

As global transactions evolve into increasingly complex versions and proliferation of multinational corporations continues to shrink the world, the dramatic internationalisation of business, accompanied by an exponential increase of the dollar amounts in question has exposed the inefficacies of the traditional methods of determining the arm's length standard which are unable to deliver acceptable outcomes.

In this backdrop the announcement made by the Finance Minister in Aug 2012 still reverberates today as India's stand before the world –

"Clarity in tax laws, a stable tax regime, a non-adversarial tax administration, a fair mechanism for dispute resolution, and an independent judiciary will provide great assurance to investors. We will take corrective measures wherever necessary."

The Advance Pricing Agreement (APA) programme in India and the resurgence of the collaborative MAP process coupled with salutary announcements by the Government of India are expected to allay the fears of the International Community as India surges ahead to discard the adversarial approaches to controversy management.

The views expressed in this article are entirely the personal views of the author.

CA Darpan Mehta & CA Gaurav Shah

Transfer Pricing for Specified Domestic Transactions – Insights and Emerging Issues

Background

Arm's length pricing of transactions between domestic related parties came up for adjudication before the Hon'ble Supreme Court (SC) in the case of Glaxo SmithKline[1]. While deciding the case in favour of the taxpayer based on the provisions of law applicable then, the SC opined on the need to extend the applicability of transfer pricing provisions to certain domestic transactions which had the potential of profit shifting and corresponding tax evasion.

Domestic Transfer Pricing (DTP) provisions were therefore introduced in the Indian law *vide* Finance Act, 2012. However, the coverage of domestic transactions to which transfer pricing provisions were made applicable is broader than that opined by the SC. Currently, DTP pricing provisions include the following transactions:

Tax holiday undertakings covering:

– Inter-unit transfer of goods and services;

– Transactions with entities having close connection.

Expenditure incurred between related parties defined u/s. 40A of the Income-tax Act, 1961 (the Act)

Any other transaction that may be specified

Aggregate transaction value exceeds INR 200 million in a financial year (starting from Financial Year (FY) 2015-16); INR 5 crores for earlier years (starting FY 2012-13)

In this article, the authors have attempted to summarise certain principles and positions through Frequently Asked Questions (FAQs), and discuss some of the emerging issues in the context of DTP provisions. Towards the end, some recent updates and experiences have been discussed.

1. CIT v. Glaxo SmithKline Asia (P.) Ltd. [2010] 195 Taxman 35

FAQs:

Question	Response (Authors' view)
Whether capital expenditure is to be covered within the purview of Section 92BA(1)(a)?	Based on a reading of the provisions, and the ICAI guidance Note on Transfer Pricing[2, 3], the view appears to be that ordinarily, capital expenditure would not be covered within the ambit of Section 92BA(1)(a) and transfer pricing provisions should not apply. However, in case the said expenditure is completely deductible in the current year (say, under Section 35AD), the same would be subjected to DTP provisions. This view also appears to be supported by judicial precedents[4].
Whether indirect shareholding is a relationship covered within the purview of Section 40A(2)(b), and would DTP provisions apply in case of transactions with a person having indirect shareholding in the company?	The view appears to be that only direct shareholding is to be considered for the purpose of determining persons specified under Section 40A(2).[5] Based on judicial precedents[6], a view may be taken that indirect shareholding would need to be considered for the purpose of Section 40A(2), only if the direct shareholder is holding shares as a nominee of the ultimate / indirect shareholder.
Can transactions with non-residents qualify as Specified Domestic Transactions (SDT)? For instance, whether a transaction by an Indian company with a non-resident shareholder holding 21% shares in the Indian company qualify as a SDT?	Enterprises holding less than 26% shareholding would not be considered as Associated Enterprises (AE) (assuming other clauses of Section 92A are not applicable). Therefore, transactions with such parties would not be considered as international transaction within the meaning of Section 92B. Section 92BA excludes transactions which are in the nature of international transactions. Therefore, the transaction in question would not be considered to be in international transaction. The shareholding threshold in Section 40A(2) being only 20%, transaction with a shareholder holding 21% shares would be considered as a SDT. This view has also been adopted in the ICAI Guidance Note on Transfer Pricing.[7]

2. Guidance Note on report under Section 92E of the Income-Tax Act, 1961 (Transfer Pricing) revised edition August 2013 – based on law as amended by the Finance Act, 2013

3. Refer Para 4A.11, page 35

4. Refer Sumilon Industries Ltd vs. Income tax Officer (ITA Nos 3296 &3297/Ahd/2008), M/s. Crescent Chemsol Pvt. Ltd. vs. ACIT [ITA No. 1497/ Mum/2010 dt. March 9, 2011]

5. Also refer Para 4A.16, page 37, of the ICAI Guidance Note on Transfer Pricing

6. Refer CIT vs. V.R.V. Breweries & Bottling Industries Ltd. [13 taxmann.com 2, (Del)], M/s. Tainwala Trading and Investments Co. Ltd. [TS-385-ITAT-2012 (Mum.)]

7. Also refer Para 4A.16, page 37, of the ICAI Guidance Note on Transfer Pricing

Question	Response (Authors' view)
In case a transfer pricing adjustment is made in the hands of a taxpayer on account of its transactions with a person specified under Section 40A(2), would such specified person get a corresponding reduction in its total income (corresponding adjustment)?	The second proviso to Section 92C(4) restricts corresponding adjustments in case of adjustments made on account of international transactions. However, this restriction is arguably not applicable to DTP provisions. Therefore, availability of such corresponding adjustments in cases involving primary adjustments to SDT is not free from doubt. Having said that, in the absence of a specific enabling provision allowing corresponding adjustments, a better view appears to be that such corresponding adjustments may not be permitted even in cases involving SDT.
Donations paid to persons specified under Section 40A(2) are covered within the purview of DTP provisions?	Donations paid to specified persons are not allowable deductions while computing business income of the taxpayer and hence, a better view appears to be that such expenses should not be covered within the ambit of DTP provisions.
Transfer of goods or services from one 100% tax holiday unit to another 100% tax holiday unit is to be covered within the gamut of DTP provisions?	Based on the language of the Section 80-IA(8), which includes transfer of goods or services from one eligible unit to 'any other unit', a better view appears to be that transfer to another tax holiday unit also should be subjected to DTP provisions. Further, a question arises whether, from a reporting perspective, such transaction should be reported under Clause 23A (whether the eligible unit has transferred any goods or services to another unit), or Clause 23B (whether the eligible unit has acquired any goods or services from another unit) of Annexure to Form No. 3CEB. In this connection, the authors are of the view that the above language of the Annexure to Form No. 3CEB appears to be unambiguous, and the same transaction should be reported in both the above Clauses.
Should transactions covered under Section 80 IA(10) be reported under Clause 24 of the Annexure to Form No. 3CEB, relating to transactions which result in the eligible unit earning more than ordinary profits, since this is the only specific clause dealing with transaction covered under Section 80 IA(8)?	Again, in the authors' view, the language of the Annexure to Form 3CEB is unambiguous. Clause 24 requires reporting of those transactions which have resulted in more than ordinary profits in the hands of the eligible unit. Therefore, in case the taxpayer has entered into transactions on an arm's length basis, and based on the proviso to Section 8-IA(10), the transactions is not to be considered as one resulting in more than ordinary profits for the eligible unit, such transaction may not be reported in Clause 24. Instead, such transaction could be reported in Clause 25 of the Annexure to Form No. 3CEB, from a completeness and disclosure perspective.

Other Select Issues

Do taxpayers eligible for tax holiday and incurring losses during a particular year need to comply with DTP provisions?

Some of the tax holiday provisions in Section 80-IA allow a taxpayer to select any 10 years out of 15 years to claim tax holiday in respect of their eligible businesses.

For years when the eligible unit incurs a loss, and does not select those years for tax holiday, a question arises regarding the applicability of DTP provisions for such years.

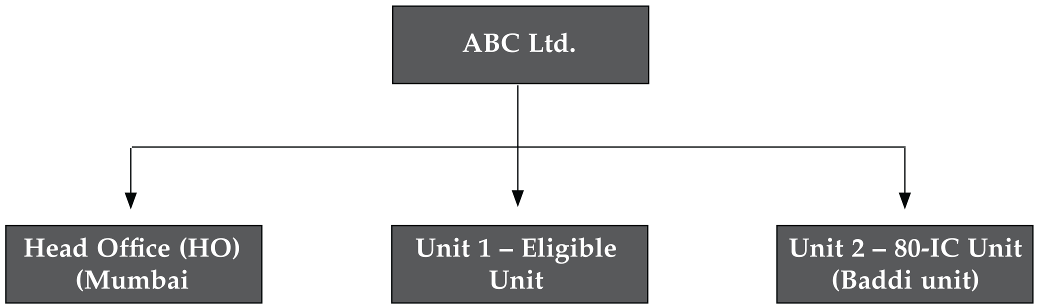
The guiding principle in respect of tax holiday units appears to be that in case losses of such years are required to be carried forward to be set off against future tax holiday profits, DTP provisions should apply. However, if the losses for such years are not required to be set off against future tax holiday profits, DTP provisions should not apply for the current year.

This has been discussed in different scenarios tabulated as follows:

Scenario	Authors' view
• Taxpayer XYZ operates a unit eligible for choosing 10 out of 15 years as a tax holiday period under Chapter VI-A; it has incurred loss in year one; • XYZ has not yet selected the 'initial assessment year' (i.e. year from which the tax holiday provisions would apply).	In case XYZ has other businesses where this loss will be eligible to be set off, this loss will not be carried forward to be set off against future profits. Even in case XYZ has only one business, Section 80 IA(5) requires that starting from the initial Assessment Year, the profits of the eligible unit shall be computed as if such eligible unit is the only source of income of the taxpayer. Therefore, losses of year 1 (i.e., before the initial assessment year) will not be required to be set off against profits during the tax holiday period.[8] Therefore, given that the tax holiday unit's current year losses are not in a position to impact its future profits potentially eligible for tax holiday, a better view appears to be that DTP provisions should not apply in the instant case.
• XYZ operates only one unit which is eligible for a tax holiday, and selects year five as the initial assessment year. • XYZ incurs losses in year five.	As noted above, as per the provisions of Section 80 IA(5), starting from the initial assessment year, the profits of the eligible unit shall be computed as if such eligible unit is the only source of income of the taxpayer. In the instant case, losses of year five will be required to be carried forward to be set off against future profits of XYZ. Therefore, since these losses have the potential to impact future tax holiday eligibility of XYZ, a reasonable view appears to be that DTP provisions apply in the instant case. In fact, even if XYZ expects to incur losses in foreseeable future, given that XYZ's actual business scenario and profitability position could change in the future, and considering the potential of tax arbitrage in case of a future profit situation, a reasonable view appears to be that DTP provisions should apply to such a case.

8. Refer Circular No. 1 of 2016 which clarifies 'initial assessment year' in the section 80-IA(5) of the Income-tax Act, 1961.

Are cost allocations covered within the purview of DTP provisions?
This is illustrated with the help of an example:



Other facts

- Products sold by Unit 1 and Unit 2 are sold to end customers; the HO does not have any other independent profit generating activity
- The HO provides oversight for the two units and incurs various administrative expenses for the two units; the employees performing these functions are common for both units, and it is not possible to identify costs directly identifiable for these units
- The HO also conducts R&D activities for the benefit of the two units. The two units deal with two different product lines and need different areas of specialisation. The employees undertaking the R&D work and other infrastructure required to perform the R&D activities are also different for the different units.

Question that arises for consideration regarding the treatment of common costs (administrative costs and R&D costs) incurred by the HO. The same is discussed below.

Issue	Authors' View
Whether allocation of costs of the administrative activities is a transaction covered under section 92BA?	In the authors' view, allocation of costs, inter-alia, for the eligible unit would signify joint ownership of functions and intangibles. Accordingly, there would not be any provision or rendition of 'services', in so far as such allocated common costs are concerned, by the HO or other parts of the enterprise in favour of the eligible undertaking or *vice versa*. Based on the same principle, a view could be adopted that administrative costs may be allocated purely at costs, and not with any mark-up. Accordingly, in the authors' view, no disclosure may be required to be made in the Form 3CEB for such transactions. Having said that, accurate identification and allocation of common costs is imperative to determine the correct amount of profits in the hands of the tax holiday unit. As a good practice, it is prudent to append a note to the Form 3CEB and file it with the tax office explaining the above position in details.

Issue	Authors' View
How should one go about determining reasonable allocation keys for the administrative activities?	All common expenses ought to be allocated on a reasonable and scientific basis (say on the basis of ratio of turnover[9], head-count[10], Cost of sales, Full-time Equivalent (FTE) etc.) depending upon the exact nature of business of the entities / undertakings to which such costs are allocated.
Does the analysis change in case of R&D activity?	The tax authorities may contend that R&D activity performed by the HO is in the nature of 'services', and that a third party would normally be willing to pay for R&D services if such services were availed from a third party. Therefore, they could argue that the HO ought to be compensated by the eligible unit for the R&D services so rendered by the HO, potentially, along with a profit element. However, a contrary view may be adopted that the HO is not an independent business / profit centre in its own right and also does not perform the services as an independent business. Accordingly, since the HO does not have any independent business motive independent of the two units, the question of rendition of services by the HO to the units at a commercial level does not arise. The question whether R&D would qualify as a service or otherwise is not straightforward and much would depend on the precise facts of the case. In any case, as discussed in the context of administrative costs, it would be prudent to append a note to the Form 3CEB and file it with the tax office explaining the position adopted by the taxpayer in details. As regards identification costs for the respective units, since the product lines and areas of specialisation required by the two units are different, and there are identifiable infrastructure and manpower involved, most of the relatable costs may be directly identifiable with the respective units.

If the relationship specified in Section 40A(2)(b) is not present for the entire year, DTP applies for the entire year, or only for the part of the year for which such relationship exists?

Section 40A(2)(b) prescribes several relationships. For the purpose of this discussion, these relationships could be broadly classified into two categories:

i) Relationships based on 'substantial interest'[11] ; and

ii) Other relationships[12].

9. Refer Controls & Switchgear Co. Ltd. vs. DCIT [2012] 204 Taxman 53 (Delhi) (MAG)

10. Refer CIT vs. EHPT India (P.) Ltd. [2012] 204 Taxman 639 (Delhi)

11. Refer sub-clause (iii) to (vi) of Section 40A(2)(b) of the Act;

12. Refer sub-clause (i) and (ii) of Section 40A(2)(b) of the Act.

Substantial interest is defined in the explanation to sub-section (2), clauses (a) and (b):

"Explanation.—For the purposes of this sub-section, a person shall be deemed to have a substantial interest in a business or profession, if,—

(a) In a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) carrying not less than twenty per cent of the voting power; and

(b) In any other case, such person is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the profits of such business or profession."

Interestingly, both sub-clauses specify that substantial interest will be deemed to exist if the specified relationship exists **'at any time during the previous year'**. Therefore, it appears that even if a person beneficially owns shares or is beneficially entitled to profits for only a part of the year, that person would be "deemed" to have "substantial interest" for the purpose of section 4oA(2)(b). Once substantial interest is established, the relationship under Section 40A(2)(b) is also established. The relationship exists for the entire year under consideration and it does not matter when the relationship arose or the period it existed for.

Section 92BA(i) provides that expenditure (paid or payable) to the "related person" under section 4oA(2)(b) would be a SDT. Therefore, once the relationship under section 4oA(2)(b) is established, as per section 92BA(i), the expenditure transaction entered into during the year with such "related person" would be a SDT.

Needless to say, the position for sub-clauses (i) and (ii) would be different. As per sub-clauses (i) and (ii), a "related person" includes a relative, director, partner, or member. Therefore, in the absence of a specific deeming provision specifying 'any time during the previous year', the relationships of relative, director, partner, and member would need to first exist and only then that person would be a "related person" for section 4oA(2)(b) purposes. Accordingly, expenditure transactions with these related persons would fall under the ambit of DTP provisions only after the relationship arises and for the period it exists.

Updates and experiences

New scrutiny guidelines

New scrutiny guidelines[13] have prescribed updated guidance on selecting cases for scrutiny, including criteria for selecting cases for transfer pricing scrutiny.

The instruction provides that where one of the reasons for selecting a case for scrutiny is a transfer pricing risk parameter[14], either for international transactions or specified domestic transactions, the Assessing Officer (AO) shall mandatorily refer the case to the Transfer Pricing Officer (AO). All international transactions or SDTs are required to be explicitly mentioned in the letter through which reference is made to the Transfer Pricing Officer (TPO).

13. CBDT Instruction No. 3 of 2016

14. Transfer pricing risk parameters are not available in the public domain.

If a case is selected only on risk parameters relating to international transactions, the SDTs cannot be referred to the TPO. Conversely, if a case is selected on risk parameters relating to SDTs, international transactions cannot be referred to the TPO. If a case is selected on risk parameters relating to both – international transactions and SDTs, both are required to be referred to the TPO.

Cases selected for scrutiny on non-transfer pricing parameters but also having SDTs[15] shall be referred to TPO in the following circumstances:

- Where the AO comes to know that the taxpayer has entered into SDTs, but has not filed Form 3CEB, or where such SDTs are not reported in the Form 3CEB
- Where there has been a TP adjustment of ` 10 crore or more in an earlier assessment year and such adjustment has been upheld by judicial authorities or is pending in appeal
- Where search and seizure or survey operations have been carried out and SDT related transfer pricing findings are made by the investigation wing or by the AO
- Where a case involving adjustment in an earlier assessment year has been fully or partially set aside by the ITAT, High Court or Supreme Court

TPO's order

The above instruction also provides guidance with respect to TPOs Order which is relevant to SDTs. The instruction provides that *"The TPO's Order should contain details of the data used, reasons for arriving at a certain price and the applicability of methods. It may be emphasised that the application of the method including the application of the most appropriate method, the data used, factors governing the applicability of respective methods, computation of price under a given method will all be subject to judicial scrutiny. It is, therefore, necessary that the order of the TPO contains adequate reasons on all these counts."*[16]

In the past, taxpayers are used to receiving detailed and reasoned orders in case of transactions where adjustments were proposed. However, as per the guidance provided in the instruction, even orders where no TP adjustments are proposed are now expected to be detailed and reasoned orders.

Benchmarking of Director's Remuneration

In the authors' recent experience of transfer pricing assessments, the transfer pricing officers are not considering the Directors' Remuneration and sitting fees as arm's length under an overall, entity level Transactional Net Margin Method (TNMM) or Other Method, without a benchmarking analysis.

Transfer Pricing Officers are expecting taxpayers to have conducted industry analysis/ benchmarking to demonstrate the arm's length nature of payments to Directors, even though such industry benchmarks may not represent comparable 'uncontrolled' transactions.

Transfer Pricing Officers are also examining in details, the CVs of the Directors, employment letters / increment letters, as well as their professional profiles available on professional networking sites such as LinkedIn. In the employment letters / increment letters, the officers are expecting to see a clear role definition of the Directors and the Key Performance Indicators (KPIs) against which they will be evaluated.

15. The guidelines also provide for cases involving international transactions, however, only cases involving SDTs are specifically discussed in this article.

16. Refer Para 4.2 of Instruction No. 3 of 2016

Eligibility of Dispute Resolution Panel (DRP) route?

Taxpayers which will face a transfer pricing adjustment in the current round of transfer pricing assessments will look for options to contest their claim. While in the case of adjustments made to international transactions, taxpayers have a choice to select either the Commissioner of Income-tax Appeals [CIT(A)] or the DRP route, question arises whether the DRP route is available to taxpayers which have suffered a transfer pricing adjustment for SDTs.

DRP mechanism was introduced in the Act in 2009, and the Memorandum explaining the provisions of the Finance Bill, 2009 suggests that the DRP mechanism was introduced to improve foreign investment by providing a dispute resolution mechanism for foreign taxpayers, or Indian arms of foreign taxpayers.[17] As a result, DRP route was made available to taxpayers which suffered transfer pricing adjustments (for international transactions, since SDTs were subjected to transfer pricing provisions much later – via Finance Act, 2009), and to foreign companies which may have suffered any other kinds of adjustments.

Interestingly, while the intention was to provide a quick dispute resolution alternative to non-residents, Section 144C of the Act provides DRP route to all taxpayers having a transfer pricing adjustment.[18] Therefore, despite the fact that the DRP was initially meant to be an effective means of providing quick dispute resolution alternative for non-residents, based on the unambiguous language of the provisions of section 144C, taxpayers which have faced a transfer pricing adjustment on account of SDTs are also eligible to opt for the DRP route, like in the case of international transactions.

Recent Rulings

There have been a few SDT specific rulings by various High Court, in response to writ petitions / special civil applications filed by taxpayers whose cases were referred to TPO in respect of SDTs. The rulings are summarized below:

Taxpayer	Summary of the High Court Ruling
Shri Satpuda Tapi Parisar Sahakari Sakhar Karkhana Ltd.[19]	The taxpayer, a Co-operative Society, made payment to few cane growers, being members of the society. Considering such payment to be an expenditure covered under the ambit of SDT as per section 92BA of the Act, the AO made a reference to the TPO. **The High Court held that 'Co-operative society' is not included in the definition of 'person' referred to in section 40A(2)(b). Accordingly, transactions entered into by a Co-operative Society could never be covered under the ambit of SDT as per section 92BA of the Act.**

17. ***"Provision for constitution of alternate dispute resolution mechanism:*** *The dispute resolution mechanism presently in place is time consuming and finality in high demand cases is attained only after a long drawn litigation till Supreme Court. Flow of foreign investment is extremely sensitive to prolonged uncertainty in tax related matter. Therefore, it is proposed to amend the Income-tax Act to provide for an alternate dispute resolution mechanism which will facilitate expeditious resolution of disputes in a fast track basis."* – Refer Pages 18 and 19 of the Memorandum to the Finance Bill, 2009 – Part 1.

18. As per Section 144C(15)(b), "eligible assessee" means,-

(i) Any person in whose case the variation referred to in sub-section (1) arises as a consequence of the order of the Transfer Pricing Officer and passed under sub-section (3) of Section 92CA; and

(ii) Any foreign company.

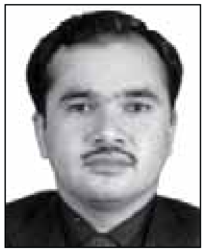
19. Writ Petition No. 6158 of 2016 – Bombay High Court

Taxpayer	Summary of the High Court Ruling
M/s. D.B. CORP LIMITED[20]	The taxpayer made certain payments, above 5 crores, to a private limited company, W. The aggregate shareholding of the taxpayer's directors along with their relatives exceeded 20% in W, though the individual shareholding of these directors and their relatives was below 20%. The AO made a reference to the TPO for transfer pricing scrutiny. **Since the aggregate shareholding exceeded 20%, the High Court decided to allow the transfer pricing procedures to carry on further without interjecting at the reference stage; although stating that the argument as to "whether or not individual shareholding or aggregate shareholding of directors along with their relatives should be considered for the purpose of determining the substantial interest (20% or more) referred to in section 40A(2)(b) of the Act" is kept open and not concluded. Accordingly, the reference made to the TPO was held to be valid.**
DSP Adiko Holdings Private Limited and DSP Investments Private Limited[21]; and DSP HMK Holdings Pvt. Ltd.[22]	The taxpayer made donations to a charitable institution. The AO referred the case to TPO on the basis that section 92BA includes 'any transactions referred to section 80A of the Act, which include deductions specified in section 80C to 80U' and accordingly, donation made would constitute a SDT. The High Court observed that AO had passed an order for making reference to the TPO, without (a) considering detailed submission made by the taxpayer and (b) providing reasons for considering the said transaction under the purview of transfer pricing provisions. **Accordingly, the High Court resorted the issue to the AO for passing a fresh order after providing his *prima facie* views and examining the taxpayer's contentions.**

Concluding thoughts

The on-the-ground practice on transfer pricing relating to SDTs is evolving, and one would need to watch out for the approach adopted by the tax authorities, and also judicial precedents over the next few years. Till then, one should take guidance from the more-evolved transfer pricing law in respect of international transactions, and judicial precedents in the case of Sections 40A(2), and 80-IA(8) and (10).

20. Special Civil Application no. 5035 of 2016 – Gujarat (Ahmedabad)
21. Writ Petition No. 1424 & 1573 of 2016 – Bombay High Court
22. Writ Petition No. 2098 of 2016 – Bombay High Court

CA Manoj C. Shah & CA Bhadresh Doshi

Penalties under Transfer Pricing Provisions

Rationale for penal provisions under the Income-tax Act

Penal provisions under the Income-tax Act (the Act) have an objective to ensure timely compliance, maintenance & furnishing of certain information / documents along with Return of Income or during the course of proceedings and the most important to ensure that taxpayer doesn't conceal income but offers to tax his real and true income.

The memorandum explaining provisions of Finance Bill 2001 states as under with respect to penalties on Transfer Pricing

"With a view to ensure that multinational enterprises comply with the requirements of the new sections, it is also proposed to amend section 271 and insert new sections 271AA, 271BA and 271G in the Income-tax Act, so as to provide for penalty to be levied in casesof non-compliance with the procedural requirements, and in cases of understatement of profits through fraud or willful negligence."

TP Provisions in India have assumed the role of Revenue Generation rather than minimizing tax avoidance:

Over the period of one and half decade of existence of Transfer Pricing (TP) provisions in India, it is observed that, instead of using TP provisions as a tool to minimize tax avoidance, it is being used as Revenue Generation means. Let's look at the observations of Tax Administration Reforms Committee (TARC) chaired by Dr. Parthasarthi Shome (page 13 of First Report)

In the direct tax area, ordinarily, transfer pricing examination between associated enterprises should be used as a tool to minimize tax avoidance. In India, transfer pricing measures are used for revenue generation, which comprises a completely wrong approach. This is revealed through the allocation of revenue targets to transfer pricing officers (TPOs) from transfer pricing adjustments. This is unheard of internationally. Accordingly, India has clocked by far the highest number of transfer pricing adjustments, demanding adjustments even for very small amounts. There is also a high incidence of variation among TPOs in their adjustments for similar transactions or deemed transactions.

Keeping in view the above observations, as well as the voluminous and external data compilation are putting assessee many a time in difficult situation and one wonders whether penalty should get attracted even if there is no tax evasion but there is merely a difference of view in methodology to compute Arm's Length Price.

Provisions pertaining to Compliances under Transfer Pricing

The transfer pricing provisions being anti tax avoidance measures, it has casted upon taxpayer stringent compliances. Sec. 92D & 92E of the Act, deals with compliances. Sub section 1 of Sec. 92D mandates the assessee having International transaction or Specified Domestic Transactions (SDT) to maintain certain information and documents. In addition, sub section 3 of Sec. 92D requires the assessee to furnish the information or documents during the course of proceedings under the Act. Also a new addition to compliance is introduced with effect from A.Y. 2017-18 by inserting sub-section 4 to Sec. 92D, which requires furnishing of information and document where an enterprise is a part of international group.

Sec. 92E casts the requirement of furnishing a report from an Accountant in respect of international transactions or SDT before specified date, i.e. report in Form 3CEB and the due date is 30th November of relevant assessment year.

So primarily the compliances revolve around

[1] Maintenance of information and documents as prescribed in Sec. 92D(1) read with Rule 10D,

[2] Furnishing of such information and documents during the course of proceedings – Sec. 92D(3)

[3] Furnishing of information and document – Sec. 92D(4) read with Sec 286

[4] Furnishing of report – Sec. 92E.

Reference to penalty provisions

Non compliance with above provisions leads to levying of penal provisions under Sections 271AA, 271BA and 271G, unless there is a reasonable cause for the failure in complying – Sec 273B. It needs to be borne in mind that these penal provisions are in addition to penalty under Explanation 7 to Sec 271(1)(c)- concealment penalty which may be levied due to adjustment in Arm's Length Price.

Section 271AA (1): Penalty for failure to keep and maintain information and document in respect of International or Specified Domestic Transactions:

Section 92D(1) provides that every person entering into an international transaction or SDT shall keep and maintain such information and documents as may be prescribed in this regard under rule 10D. This Rule prescribes for maintaining documentation about FAR (Functions, Assets & Risks) analysis and other information as prescribed therein.

Nature of Offence: The penal provisions of Sec 271AA(1) would trigger in following circumstances.

(i) Failure to maintain documentation prescribed

(ii) Failure to report such transaction and

(iii) Maintaining or furnishing an incorrect information/document

Quantum of Penalty: 2% of the value of International Transaction or Specified Domestic Transaction

Section 271BA: Penalty for failure to furnish report under Section 92E

Section 92E provides that every person entering into an international transaction or specified domestic transaction shall obtain a report from an accountant in the prescribed form and shall furnish the same on or before the date prescribed in this regard. Failure to furnish Accountant's report in Form 3CEB as required by Section 92E may lead to penalty of ` 1,00,000/-.

However, Kolkata Tribunal in the case of J.J. Exporters Ltd. Vs CIT, considering the facts of the case – that it was the first year of assessee having International Transaction, though report u/s. 44AB was filed, the tax auditor also was unaware of requirement of 92E and further taking into consideration that in all the subsequent years, the report u/s. 92E was filed, ruled in favour of assessee and dropped the penalty.

Section 271G: Penalty for failure to furnish information or document under section 92D(3)

This provision gives power to assessing authority to call for information or document during the course of proceedings [and therefore it differs to this extent from Sec. 271AA(1)] and failure on the part of assessee to furnish information or document can lead to levying of penalty. The purpose of this section is to ensure a timely adherence to the notices issued to taxpayer, failure of which may trigger a penalty of 2% of the value of such transaction for each failure.

If during the course of assessment, the assessee fails to furnish the information required under Section 92D(3) of the Income-tax Act, within 30 days of the date of receipt of notice, penalty would be levied under section 271G of Income-tax Act. On an application made by the assessee, the Assessing Officer or the Commissioner or the Transfer Pricing Officer may extend the period by further 30 days. So this penal provision is in addition to 271AA which requires assessee to maintain report and furnish correct information. While one can understand that non-reporting of a particular transaction or furnishing incorrect information can lead to penal provisions under 271AA, however, for non- maintenance of documentation there cannot be penalty under two separate provisions, i.e. under 271AA as well as 271G. Having not maintained documentation [as per Sec. 92D(1)], there will be contravention of 271AA and in view of fact that documentation has not been maintained, there is no question of furnishing same. Reliance for this contention can be placed upon the decision of Chennai Tribunal- Tussor Machine Tools India Pvt. Ltd. ITA No./1270/2012. In this case, the assessee had not maintained documentation nor filed Audit report in Form 3CEB. During the course of assessment proceedings u/s. 143(3), it didn't produce the documentation as well as Audit Report, however, it submitted the Audit Report after the assessment but during the course of penalty proceedings. The Tribunal, held that, penalty was not eligible u/s. 271AA, as assessee cannot be said to have not maintained documentation, the Assessing Officer, in such circumstances should have invoked more specific penalty provision of Sec. 271G. Though this decision pertains to Sec. 271AA, as it existed prior to amendment by F.A. 2012, the principle with respect to overlapping of penalty for non-maintenance of documentation, seems to still hold good.

In the case of *ACIT vs. Global One India Pvt. Ltd. [2012] 19 taxmann.com 429*, the Delhi Tribunal held that Notice u/s. 92D(3) must mention specific information to be furnished by assessee. The penalty u/s. 271G could arise only in event of failure of assessee to support its ALP by filing necessary evidence and then only the question of requiring assessee to furnish prescribed information would arise. The decision further goes on to state that "In penalty orders passed by Assessing Officer, if there is nothing to suggest as to which particular information or document is not submitted by assessee nor exact nature of default has been brought out, penalty u/s. 271AA, 271G and 271BA cannot be levied upon the assessee."

Further support to above contention can be drawn from the decision of Delhi Tribunal in the case of *Cargill India Pvt. Ltd vs. DCIT [2015] 60 taxmann.com 35*. The Tribunal stated that -the Documentation requirements prescribed under Rule 10D are quite voluminous. It emphasised that the compliance of procedural provisions must be based on meaningful interpretation of the law. The requirement of the law is not for the taxpayers to maintain each and every document/information prescribed under Rule 10D but only those as applicable depending on facts and circumstances of each case. A substantive compliance of the requirements of Rule 10D ought to be considered as sufficient and penalty need not be levied u/s. 271AA or 271G. Also reliance can be placed on Delhi High Court decision in the case of *CIT vs. Bumi Hiway [2014] 51 taxmann.com 572.*

Section 271(1)(c)

In case when any amount is added or disallowed in computing the total income under sub-section (4) of section 92C (computation of ALP), then, the amount so added or disallowed shall be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished.

Of course the levy of penalty is not automatic, it will trigger only if assessee fails to prove to the satisfaction of AO or Commissioner (Appeals) that the ALP was determined in good faith and with due diligence. [Explanation 7 to Sec 271(1) (c)]. Thus, the onus of proving that the transfer pricing exercise was carried out in good faith and with due care is shifted to the assessee.

The Mumbai Tribunal in case of *RBS Equities India Ltd. [2011] 13 taxmann.com 30* held that the expression good faith used along-with due diligence which refers to 'proper care', means not only must the action of the taxpayer be in good faith, i.e. honestly, but also with proper care. An act done with due diligence would mean an act done with as much care as a prudent person would take in such circumstances. As long as no dishonesty is found in the conduct of the taxpayer and as long as he has done what a reasonable man would have done in his circumstances to ensure that the ALP was determined in accordance with the scheme of S 92C, deeming fiction under Explanation 7 cannot be invoked.

Specific instances & implications of penalty provisions

Absence of current year data in public domain: Relying on multiple year data and non availability of current year data in public domain at the time of filing of return of income cannot be the reason to levy penalty. It could not be said that computation by assessee was not in accordance with provisions of Section 92C so as to justify imposition of penalty u/s. 271(1)(c) – [2016] 69 taxmann.com 34 (Mumbai – Trib.) *DCIT vs. Symantic Software Solution (P.) Ltd.*

Difference in opinion on selection of Most Appropriate Method between assessee and TPO: It was held in the case of *ACIT vs. Boston Scientific India (P.) Ltd.,[2016] 67 taxmann.com 28* that mere change in opinion of Assessing authority with respect to selection of method cannot be the reason to levy penalty. The Tribunal held that the assessee was fully within the arm's length price, and no *mala fide* has been alleged by the revenue to show that selection of the other method was with a deliberate attempt to defraud revenue. Also held similarly in the case of *[2016] 70 taxmann.com 123 (Delhi Trib.) Mitsui Prime Advanced Composites India (P.) Ltd. vs. DCIT & [2012] 17 taxmann.com 74 – ACIT vs. Pentasoft Technologies Ltd.*

When income is not liable to tax in view tax treaty

For example, a transaction between two non residents (both of whom are AE) of transfer of shares of an Indian company leading to accrual of capital gains in the hands of transferor non resident. However, due to accessing of tax treaty the transaction is not liable to income tax Indian, and hence the question arises, whether the non resident should have filed the tax return and consequently complied with Transfer Pricing provisions also.

In support of the contention of 'Not required to file Return of Income', one may rely on the AAR [2015] 65 taxmann.com 245 in case of Dow Agro Sciences. The AAR relied on the ruling of Factset Research Systems Inc. 317 ITR 169 and Vanenburg Group B.V. vs. CIT AAR No. 727 of 2006 and observed the following –

"So far as filing of Income Tax return is concerned, it may be mentioned that the liability to pay tax is founded upon Sections 4 and 5 of the Act, which are the charging sections. Section 139 and other sections are merely machinery to determine the amount of tax. There would be no occasion to call machinery sections in aid where there is no liability at all. Reference to this connection may be made to Chatturam vs. CIT [1947] 15 ITR 302 (FC). Therefore, there is no need to file return of income for the applicant."

However, there are conflicting ruling also, and in AAR VNU International BV [2011] 198 Taxmann 454 (AAR – New Delhi) and Ardex Investments Mauritius Ltd. [2011] 16 taxmann.com 84 (AAR – New Delhi). In these cases, it was held that, there is a requirement to file the Return of Income.

Summarising

The penal provisions turn quite sensitive in view of its quantum which is linked to 2% of value of international transactions or SDT and hence due care needs to be taken while capturing the transactions for correct reporting along with exercising due diligence in arriving at ALP.

Case Laws Index

CA J. K. Mittal

HOT SPOT
Service Tax Audit: "Analysis & Implication of Mega Cab Judgment"

Self-assessment

Like in any other fiscal statute, the Service Tax also opted long time back for Self-assessment. Meaning thereby, the service providers have to assess his tax liability, pay tax and file return at his own. As such, the principle of self-assessment is based upon the philosophy that the Government repose trust on the tax-payers. In that situation, the tax department selectively and objectively picks up few assessees every year for scrutinising their return and accounts for the purpose of possible discrepancies in payment of tax by the assessee. However, rest of the assessees are not checked up and deemed to have paid their due tax.

Audit of every assessee records defeats the very purpose of self-assessment

It has been experienced that under the Income Tax Law, the philosophy of self-assessment tax is followed by the Department in true spirits that is why out of the four crores assessees, only about returns of the four lakhs assessees are scrutinised. However, under the Service Tax, the Department always wishes to conduct audit for each and every assessee. Whereas for the bigger assessee, they want to audit every year and smaller assessee even may be once in 5 years, in that case, audit shall be conducted for the record of the past 5 years. It is experienced that every assessee practically receives letter from the Service Tax and Central Excise Department to produce the records for the last 5 years or for the period subsequent to the last audit conducted, for the purpose of audit by the officers of the Department. Therefore, if in real sense we see, that defeats the very purpose of self-assessment adopted under the Service Tax Law.

Objective of the audit is not very clear

Second problem under the service tax audit is that when the audit is conducted for the last several years, if the audit is to be conducted for more than one year, it virtually become investigation rather than an audit and when the recovery of the tax is limited to one year (later enhanced to 18 months and now 30 months), then conducting audit beyond this period virtually means the officers are proceeding on the premise that there is fraud, collusion, wilful misstatement or suppression of facts by the assessee which empowers the officer to recover the tax beyond the aforesaid stipulated period. Whereas the principle of audit is that the audit should be conducted as a watchdog and not as a bloodhound. Therefore, the auditor is to proceed with the premise of fraud, suppression, etc. then it cannot be called audit, rather it becomes an investigation. Therefore, it appears that objective of the audit is not very clear and it appears that it run counter with the objective of the self-assessment adopted under the fiscal statute, as in that case, there cannot be audit of 100% assessees and if the audit is left out in one year, then the officer will conduct the audit in subsequent year for all pending previous years, maximum up to 5 years. This is not only harassment to the assessee but creating trust deficit between the tax-payers and the tax collectors.

Show Cause Notice directly on the basis of Audit observations

It has also been experienced that the Department sends very junior level officers of the rank of Inspector/Superintendent for conduct of audit. Even for every year records, the audit is being conducted in just couple of days, which obviously become a formality, rather than achieving the objective. Surprisingly, the Superintendent under the law has no power to adjudicate and demand any service tax (except in rarest case up to ` 1 lakh) but after conducting audit, the Superintendent issues audit memos or orally asking the assessee to pay huge amount of tax with interest and in case, the assessee refuses to accede to the point raised by the Superintendent, such audit objection is converted into a Show Cause Notice, generally without there being any discussion by the senior level officers with the assessee. Therefore, virtually the Superintendent becomes the last man to decide about the audit objection, which itself is contrary to the law as he has not been vested with such powers to demand any tax after conducting audit. Senior level officer up to the rank of the Commissioner while issuing the Show Cause Notice virtually copies the audit objection of the Superintendent without inviting the assessee. Probably that is why the Ministry of Finance now issued Instruction dated 25-4-2016 by making it mandatory for the Commissioner or Pr. Commissioner to have consultation with the assessee prior to the issuance of the Show Cause Notice involving demand beyond ` 50 lakhs. Whereas, the principle of the audit should have been that if the junior officers of the Department have any observation about the assessee business activity or records, they should invite the attention of the assessee through their senior officer in writing and the senior officer must consult with the assessee across the table. If this approach would have been adopted, it would have probably been more acceptable to the assessee. However, the Department probably feels that by audit measures, revenue could be enhanced.

Department asking records for audit which are not even mandated under the law

It has also been observed that while conducting the audit, the departmental officer directs to the assessee to prepare various reconciliation and the information in various formats, which is not prescribed in the law at all. Such kind of directions, which are not mandated under the law, is called cumbersome to be followed by the assessee and of course cause serious harassment. The Department also demands long list of documents to be produced as well as number for formats, which *de hors* the provisions of law. It consumes lot of time of the assessee and of course expenditure also. Therefore, in nutshell if it is seen the very objective of the audit is not very clear as it should have been a selective check of the record of few assessees.

Background of Audit provisions under Service Tax Law

The Finance Act, 1994 does not contain any provisions empowering officers of the Central Excise or the Service Tax Department to conduct audit of the records of the service tax assessees. However, the provisions of the Special Audit are contained under Section 72A of the said Act but therein the special audit can be ordered to be conducted only by the Chartered Accountant or the Cost Accountant. However, the sub-rule (2) of Rule 5A of the Service Tax Rules, 1994 contains the provisions regarding the audit by the officers of the Department, which for the first time was introduced in the year 2007. However, the same was struck down as *ultra vires* by the Delhi High Court in the matter of *Travelite (India) vs. UOI 2014 (35) STR 653 (Del.)* and the court observed that there is no reason for giving such a sweeping power to the officers for conducting audit when the Parliament by law have envisage and made provisions of Special Audit in the Act itself and held that sub-rule (2) of Rule 5A is *ultra vires* to Act as such provisions are not backed by the statutory provisions. Thereafter, the said sub-rule (2) of Rule 5A was again substituted with a new set of rules w.e.f. 5-12-2014 but with more or less similar approach to the earlier provisions except extending audit by the Chartered Accountant or Cost Accountant in terms of Section 72A of the Finance Act, 1994. However, the Department felt that in view of the clause (k) introduced in sub-Section (2) of Section 94 of the Act, now, the Department armed with the power to conduct audit through their officers, however, the said rule was again challenged before the Delhi High Court in *Mega Cabs Pvt. Ltd. vs. UOI and Anr. reported in 2016 (43) STR 67 (Del.)* whereby the Hon'ble Delhi High Court again struck down Rule 5A(2) as *ultra vires* and also clarified that the expression 'verify' used in Section 94(2)(k) of the Act does not include audit. In addition to that the Delhi High Court also struck down the Circular No. 181/7/2014-ST, dated 10-12-2014 wherein the Board had clarified that the new Rule 5A(2) has now got statutory backing in terms of Section 94(2)(k) of the Act, however, the Hon'ble High Court did not accept this contention of the Board. Further, the Hon'ble High Court also quashed the Circular No. 995/2/2015-CX dated 27-2-.2015 whereby the Board has formulated the norms to be followed by the Audit Commissionerate while conducting audit by the Central Excise and Service Tax Departments. Further, the High Court again struck down the Audit Manual, 2015 as *ultra vires* without having any statutory backing. Whereas, the Audit Manual 2011 was struck down by the Delhi High Court in the earlier judgment of the Travelite (supra). It may be noted that the Government on the one hand got ex-parte stay against the judgment of the Travelite (supra) from the Supreme Court, on the other hand, amended the law. Therefore, there is a self-contradiction on the actions of the Government. In any case, once the new law has been struck down, the stay on the earlier judgment of the Travelite has no bearing. After striking down Rule 5A(2), not only the officers from the Central Excise and Service Tax Department but officers of the Comptroller and Auditor General of India (C&AG) has also no power to visit the premises to conduct the audit of the records of the service tax assessee. Therefore, no assessee is bound to produce them the record for conducting audit under the aforesaid provisions. Though, the aforesaid provisions are in respect of service tax but the similar provisions have been made in the Central Excise Rules also, therefore, the aforesaid judgment shall apply to the audit if any conducted by the officers in respect of the records of the Central Excise assessee. In the Mega Cab judgment, the Delhi High Court has made several observations which have a far reaching implication, as discussed hereunder:-

(i) **No reassessment:** In para 16 of the Mega Cab judgment, the High Court has observed that there is no provision in the Finance Act for reassessment of service tax return and this principle has again been reiterated by the Delhi High Court in recent judgment dated 1-9-2016 in *Ebiz.com Pvt. Ltd. vs. UOI* and *Makemytrip vs. UOI* that under the Finance Act, there is no power of re-opening of assessment. Therefore, in the garb of the audit/inquiry/investigation, if the Department revisits the same records of the assessee, which have already been verified by the other wings of the Department, it cannot be permitted.

(ii) **For best judgment assessment under Section 72, records can be called by the officers who have power to make assessment:** In para 17 of the Mega Cab judgment, the High Court has observed that even while making assessment under Section 72, the principle of natural justice has to be observed and the Assessing Officer cannot call the records mechanically but only after arriving at a *prima facie* situation that the return filed by the assessee did not assess the tax in accordance with the law, only then the records could be called. Whereas, this is important as under Rule 5A(2), the Department was having unfettered powers as without giving any reason routinely records were being called for the last several years for the purpose of audit and the assessee had no opportunity to contest that no audit can be conducted. As discussed above, while conducting the audit, the officer at the level of Superintendent also frames his opinion for demanding tax liability whereas under the law, he has no such power. Therefore, the observation made by the High Court in para 18 of the judgment is very relevant. Whereas, it has been observed while making assessment under Section 72, any or every officer of the Department cannot exercise the power. Therefore, those who have the power to make assessment, only can call for the records. Whereas, audit functions under the service tax was being performed by the officers those who have no power to make assessment.

(iii) **Special Audit under Section 72A is also required pre-decisional hearing opportunity:** In paras 22 and 24 of the Mega Cab judgment, the High Court has observed that even while directing for Special Audit under Section 72A, it is mandatory to give assessee an opportunity for hearing prior to passing an order of a Special Audit as an additional safeguard against the arbitrary exercise of power of the Commissioner of the service tax to order a Special Audit. Therefore, while the Parliament has enacted a provision for the Special Audit in the Act itself, the Court is of the view that even though the provision does not contain, a pre-decisional hearing to the assessee giving reason for directing the Special Audit is implicit, so that the assessee can contest that no Special Audit is required to be conducted for his records. However, in the Rule 5A(2), which has now been struck down, contained no safeguard at all. Therefore, while striking down the provisions wherein no safeguard was there, the High Court felt it necessary even to provide safeguard for the purpose of carrying out Special Audit under Section 72A, in the form of providing opportunity of hearing to the assessee prior to direction of Special Audit. In these circumstances, Rule 5A(2) could not have stand its legs as while directing the audit under the said rule, there was no reason was required to be given and no period was prescribed for which audit could have been conducted. Therefore, it was open invitation to arbitrary exercising of power by the officers and it is not wrong to say that it was being exercised in highly arbitrary manner throughout the country.

(iv) **Records under section 73 even could not be called without providing opportunity of hearing:** In para 26 of the Mega Cab judgment, the High Court has further compared Rule 5A(2) where the records were being simply sought on demand without giving any reason. Whereas, the Delhi High Court observed that even under Section 73, there is no question of assessee being asked to produce record simply on demand without being given any opportunity of hearing in respect of assessee's version of the case.

(v) **Search Power under section 82 hedged with limitations/safeguard:** In para 28 of the Mega Cab judgment, the High Court has also observed that even the search power of the officers is hedged by certain limitation and the officer has to record the reason to believe before ordering for the search. Therefore, when the provision under the Act whether it is for Special Audit or for the search or other provisions as the safeguard, it is difficult to understand how the Government has re-inserted Rule 5A(2) empowering officers to conduct audit without providing any safeguard despite the fact the said rule earlier was struck down by the Delhi High Court in Travelite judgment (supra).

(vi) **Seeking records which no prescribed under Rule 5(2) is beyond the power under the Act:** In para 32 of the Mega Cab judgment, the High Court has observed that records sought under Rule 5A(2) for conducting audit was far beyond and exceeding the record prescribed under sub-rule (2) of Rule 5 and not even under any other provisions and the Finance Act, 1994. Thus seeking those records for conducting audit was held to be going far beyond the Finance Act itself.

(vii) **Any or every officer if allowed to seek records, without recording reason, will result into harassment:** In para 30 of the Mega Cab judgment, the High Court accepted the contention of the counsel of the petitioner that if any and every officer is allowed to be deputed for the purpose of conducting audit, without any reason to believe for the production of record, it would result in harassment of the assessee.

(viii) **Act does not empower C&AG officers to conduct audit of private assessee:** In para 35 of the Mega Cab judgment, the High Court has also accepted the contention of the counsel of the petitioner that the power of the CAG for conducting audit is given under Constitution of India as well as CAG Act, 1971. Therefore, it was held that there is no rationale under Rule 5A(2) to produce the documents of a service tax assessee on demand to the CAG officer and it was held that when there is no authorisation under the Finance Act empowering CAG officer to conduct the audit of the records of the service tax assessee, such power cannot be given to the CAG officer to access the books of account of the service tax assessee.

(ix) **The power of the verification of the records only vests with the officers who have the power to assessment and adjudication:** In paras 36 and 38 of the Mega Cab judgment, the High Court while referring Circular dated 27-2-2015 observed that such an instruction justifies the apprehension regarding the indiscriminatory use of power under Rule 5A(2) while referring the said Circular which authorises the Superintendent and Inspector for conducting audit, the High Court observed that there is no requirement that any of these officers should be duly authorised to carry the assessment under Section 72 of the Act or adjudication for the purpose of Section 73 of the Act. Therefore, if the High Court's observation is seriously considered by the Central Government, then one will find that the practice adopted by the Department to screw the assessee through the Superintendent is without any legal power. Surprisingly, the Departmental Officers at all levels issue letters in the name of service tax inquiry, verification, etc. without having any legal provisions and aforesaid observation of the High Court and the entire judgment if seen in right perspective clearly indicates that the power of the verification of the records only vests with the officers who have the power to assessment and adjudication and not with the officers at the level of the Superintendent and Inspector.

(x) **Audit Manual 2015 has no statutory backing:** In para 37 of the Mega Cab judgment, the High Court has observed that the Audit Manual 2015 again failed to acknowledge that there is no statutory backing for the officer of the Department to themselves undertake audit of the assessee records and lacunae pointed out by the Delhi High Court in Travelite (supra) has not been set right.

(xi) **Expression 'verify' used in Section 94(2)(k) does not cover audit:** In para 38 of the Mega Cab judgment, the High Court has rejected the contention of the Department as contained in Instruction dated 10-12-2014 that expression 'verify' used in Section 94(2)(k) of the Act is wide enough to permit audit of the accounts of the assessee by an officer of the service tax department. The High Court reiterated that verification of the records can be done only by those officers who are authorised to undertake assessment or adjudication. Thus, the effect of this judgment is that the Superintendent is totally barred for making verification of the assessee's record as they are empowered to make assessment or adjudication. It is a great relief for the assessees throughout the country.

(xii) **Audit only by Chartered Accountant or Cost Accountant:** In para 39 of the Mega Cab judgment, the High Court has observed that there is a distinction between audit of accounts of the assessee and verifying the records of the assessee. Audit is a special function, which has to be carried out only by duly authorised persons like Chartered Accountant or Cost Accountant. The High Court observed that it cannot possibly be undertaken by the officer of the service tax department. The High Court has rightly observed so that is why when the Special Audit provisions are there under Finance Act or may be under other fiscal law, like Central Excise or Income-tax, such audits are directed to be conducted by the Chartered Accountant or Cost Accountant.

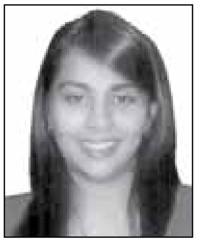
(xiii) **Rule 5A(2) exceeds the scope of the provisions of the Act:** In para 39 of the Mega Cab judgment, the High Court has considered the Supreme Court decision cited by the Counsel of the Petitioner regarding the delegation of power to subordinate legislation, held that there is no hesitation in concluding that Rule 5A(2) exceeds the scope of the provisions of the Act and in the garb of rule making power, Central Government cannot arrogate to itself power, which is not contemplated to be given it by the Parliament. The High Court observed that this is an instance of the executive using the rule making power, which is far in excess of what shall be delegated to it by the Parliament. The High Court has tested Rule 5A(2) *vis-à-vis* to the provisions of Section 72 of the Best Judgment Assessment, Special Audit under Section 72A and power of adjudication under Section 73 and the power to search under Section 82.

Is Mega Cab judgment applicable throughout country? The Supreme Court in the case of *Kusum Ingots & Alloys Ltd. vs. Union of India, 2004 (168) ELT 3 (SC): AIR 2004 SC 2321 : (2004) 6 SCC 254* "An order passed on writ petition questioning the Constitutionality of a Parliamentary Act whether interim or final keeping in view the provisions contained in Clause (2) of Article 226 of the Constitution of India, will have effect throughout the territory of India subject of course to the applicability of the Act." This principle was also repeated in the case of *Canon Steels P. Ltd. vs. CC, 2007 (218) ELT 161 (SC) : 2007 (13) SCALE 77 : 2009 (15) STR 97 (SC)* held that "an order passed in writ petition questioning Constitutionality of a Parliamentary Act, whether interim or final, keeping in view the provisions contained in clause (2) of Article 226 of the Constitution of India, will have effect throughout the territory of India, of course, subject to the applicability of the Act." The Rule 5A(2) of the Service Tax Rule, 1994 has throughout the territory of India, which is enacted under the Central legislation. Therefore, unless the High Court of the State gives a contrary judgment, it will be applicable throughout the territory of India.

Conclusion

The Mega Cab judgment has analysed various facets of the Finance Act, 1994 while testing the validity of Rule 5A(2). The observations made by the High Court in the said judgment has far-reaching implications particularly the power of the officers to verify the records, restricted to only those who have power to make assessment or adjudication. The High Court observed that the audit probably cannot be undertaken by the officer of the service tax department, which also appears to be based on well sounded principle and probably that is why the reason, in all statutes, the Special Audit is conducted through Chartered Accountant or Cost Accountant. It is expected that the Central Government will analyse the principle of law laid down in Mega Cab judgment and set its house in order.

Editorial Note: Author of its Article is a practising advocate and argued the Mega Cab case before the Delhi High Court. The author of this article has been taking the stand over more than a decade that the audit by the Central Excise Office & Service Tax Department and CAG officers are not legally sustainable.



Dhrumi Chetan Dedhia

Religion & Terrorism

Introduction

As Modi Government rises with its aspiration of re-creating India, bringing in a new style of leadership to Indian Politics. Our Prime Minister, Mr. Narendra Modi has its own vision towards the country and at the same time enmeshed many practices and projects as a part of his mission to redefine India. His primary focus, along with most of our former Prime Ministers', lie in addressing the problems faced by the country by undertaking reformative actions through launching various campaigns, schemes and programs. The recent Union Budget delivered by Mr. Jaitley reflected the urge to promote India across the globe by captivating foreign Investments that shall help foster its growth and development and also to bring the country at par with other developed democracies of the world. "Make In India", "Swachh Bharat Abhiyan", "Digital India", "Skill India", are a few publicised initiatives taken by the Union. However, it has been noticed by many of us that a number of initiatives taken up by the Prime Ministers, ranging from the past, cannot follow the precedents set respectively, by Jawaharlal Nehru, Indira Gandhi and by the Mahatma himself. In what way then does the new Government represent India's past? There are talks of revolutionising India but how about the assets that it currently dwells? While the promise of India's future seems unlimited, the past still lays its roots tight, strengthening the foundation and creating a strong platform for tomorrow's India.

"India is the only millionaire – the one land that all men desire to see, and having seen once, by even a glimpse, would not give that glimpse for all the shows of all the rest of the globe combined."

– Mark Twain[1]

In the quest of being what we aren't, the wealth that we already inherit has been obliterated. India seems to have been undergoing a plastic surgery, whereby people are trying to incorporate all the good elements of an 'ideal nation', resulting in the loss of its very own identity. Is that the ultimate purpose of recreating India? In the course to modernization and progress are we stripping off our identity and the rich heritage that we have been blessed with? Can we reshape India, not through international treaties or dirty politics but through the magnificent rich priceless heritage that have been bestowed upon us by our ancestors?

1. Mark Twain, Following the Equator (1897)

India in its cradle years

When India became independent, its leaders, especially its first Prime Minister, had high hopes that India would become a moral leader, that it would forge a path of peace and understanding in a world torn apart by enmity between the West and the East. The illustrious list of freedom fighters is indeed long and includes Bhagat Singh, Chandra Shekhar Azad, Sarojini Naidu, Sardar Vallabhai Patel, Mahatma Gandhi, Lokmanya Tilak, Lala Lajpat Rai, Jawaharlal Nehru and Gopal Krishna Gokhale. Their zeal and conviction inspired many people to participate in the freedom struggle that eventually led to the British leaving India, enabling the country to formally declare independence on 15th August, 1947.

"Long years ago, we made a tryst with destiny and now the time comes when we shall redeem our pledge... At the stroke of the midnight hour, when the world sleeps, India will awake to life and freedom."

– Jawaharlal Nehru[2]

Having achieved political independence in 1947, through national planning the Indian Government set itself the goal of freeing India's masses from poverty, ignorance and disease. The Partition of British India led to the creation of two sovereign states, both dominions: Pakistan and India. In the early 1950s, when the bureaucratic machinery of India stifled every bit of enterprise and the State controlled every decision, there came a handful of players who would take the stage decades later as key actors in bringing the Indian Industry into the modern age.

When India turned Sixty

Year 2007 marked completion of the nation's sixty glorious years of existence. When at the age of sixties, the journey of age marks, wrinkled skin, poor eyesight and brittle teeth commences, India was still in its school days battling its way to growth and success. But on its sixtieth birthday there was a lot to celebrate. Rapid economic growth during the last decade-and- a-half had brought per capita income to the magic figure of $1000[3]. There were still a lot of people below the official poverty line, but if there were one in two when India was thirty years into Independence, now there were one in five[4]. Indian Industrialists were taking over businesses abroad even in the land of their own masters – The British. India was beginning to figure in respectable numbers in the list of billionaires. Every country has its mega-rich. For a country that so many people think of, in terms of teeming poor and bedraggled beggars, to have many thousands of millionaires and even billionaires, to be a standout group on the Forbes List of the 'World's richest people, has to stir the curiosity.

Heritage – Lets sink in

In common parlance, the moment we hear the term 'Heritage', at the very next micro millisecond, what strikes our psyche is the great Indian monuments. Most of us are mistaken by the fact that Heritage is restricted to the architectural formations and structures. But the word 'Heritage' has a lot more in it to say.

The term 'Heritage' is defined as:

"The traditions, achievements, beliefs, etc., that are part of the history of a group or nation."[5]

2. "Tryst with Destiny" was a speech delivered by Jawaharlal Nehru, the first Prime Minister of independent India, to the Indian Constituent Assembly in the Parliament, on the eve of India's Independence, towards midnight on 15th August 1947, Following the Equator (1897)
3. The book, "Rediscovery of India" by Meghnad Desai
4. Wikipedia-The Economy of India
5. As defined by Merriam-Webster's Dictionary

"Valued objects and qualities such as historic buildings and cultural traditions that have been passed down from previous generations."[6]

Thus, 'Heritage' embodies a lot more elements if we sink in. It is universal and can be used in reference with many situations. Where the term 'Indian Heritage' encompasses the cultures, traditions and structures inherited from its past, the term Heritage in relation to family shall include all the values, beliefs, cultures and elements acquired from the ancestors.

Indian Heritage – A Brief Introduction

"No other country has lived with so complicated a past so equably, assimilating everything that has happened to it, obliterating naught, so that not even the intricate histories of European states have produced such a rich pattern as that bequeathed by the Mauryas, the Ashokas, the Pahlavas, the Guptas, the Chalykyas, the Hoysalas, the Pandyas, the Cholas, the Moghuls and the British to identify a few of the people that have shaped India's Inheritance."

– Geoffrey Moorhouse[7]

"Unity & Diversity" is what India is known for! Diversity with respect to its language, culture, traditions, people, geography and much more. India is blessed with a vast and rich heritage. It is the reflection of the identity of the people of a nation. One identifies herself or himself with hers or his heritage, which gives a sense of pride. One has only to see the various architectural marvels and cultural institutions that dot the geographical expanse of India to glimpse the richness of our heritage. The opulent heritage of India unveils the magic of the past that tends to meet the present.

"India is, the cradle of the human race, the birthplace of human speech, the mother of history, the grandmother of legend, and the great grandmother of tradition. Our most valuable and most instructive materials in the history of man are treasured up in India only."

– Mark Twain[8]

The greatness of India has been in accepting the best from all the invaders and inter mingling the new customs and styles with the existing. So let us have a look at what our ancestors have left us in the gargantuan chest!

The Inestimable Gem – Indian Culture & Traditions

India is ingrained in the culture of her past. The plush fabric of Indian culture is intertwined with customs and tradition. There is a harmonious blend of art, religion and philosophy in the Indian culture. Indian culture is actually an outcome of continuous synthesis and has absorbed many external influences in the course of long journey of history. India is recognised to be the land of culture and tradition and is home to one of the oldest civilizations in the world. The exquisitely developed culture in India chiefly encompasses manners and etiquettes, the style of communication, values and beliefs. All the regions and religions of the world have their own culture with many customs, traditions and refined qualities. It is a culture of love, respect, honuring others and humbling one's own ego so that the inner nature, which is naturally pure and modest will shine forth. The culture of India greatly acknowledges seniority, respect and reverence for elders being a key stone of Indian culture

Indian Culture has tried to be so comprehensive as to suit the needs of every human being, irrespective of age, sex, colour

6. As defined by The Oxford Dictionary
7. Geoffrey Moorhouse in Om-An Indian Pilgrimage
8. Mark Twain, Following the Equator (1897)

or race. As such, it has a Universal appeal. History has not been able to trace its beginning. Purity in mind, body, speech, thought, word and deed is vitally important for us. The concept of zero and the primordial sound of Om was given by India.

"A nation's culture resides in the hearts and in the soul of its people."

-*Mahatma Gandhi*[9]

A Literary Feast

Indian Literature has always existed in time and shows no sign of decay and death, hence it is spoken of being eternal. It is called Vaidic because the earliest literature in which it found expression is the Veda, the oldest books known to the world[10]. India still holds reverence for the Vedas, the Mahabharata and the Bhagavad gita. Indian literary masterpieces are written in epic form, corresponds to the great epochs in the history of India. They are original scriptures of Hindu teachings, and contain spiritual knowledge encompassing all aspects of our life. The Ramayana and the Mahabharata are the most important epics of India; the latter is the longest epic in the world. Indian Literature is eclectic and contains great wisdom, knowledge or vision, and it manifests the language of the gods in human speech.

"To subvert is not the aim of literature, its value lies in discovering and revealing what is rarely known, little known, thought to be known but in fact not very well known of the truth of the human world. It would seem that truth is the unassailable and most basic quality of literature."

– Gao Xingjian[11]

Also, India is a production house for several great writers who, by their exhilarating writings have influenced a whole generation and continue to inspire the upcoming generations. Indian writers have played a progressive part in the revolution of the Indian society. They draw forth the thought of successive generation of thinkers. Proficient Writers like Bankim Chandra Chatterjee, Premchand, Rabindranath Tagore along with many more, shall always be recognized for their ingenious works.

Indian Art & Architecture

India is a rich reservoir of architectural designs because of the country's motley history. India's past is a mosaic which mingles design concepts from all over the world. Our ancestors have flowered concepts and ideas of design in Indian Architecture. As a result, India's celebrated buildings and monuments have become the cynosure of the world's eyes. According to many leading architects of India, Indian architecture is difficult to define because so many streams of artistic genius have enriched it. While Vastushastra[12] and Sthapatyashastra[13] are the original sciences which developed during the early centuries of the last two millenniums, later, building and design styles came from the Mughals, Rajputs, the British, the French, the Portuguese, the Spanish, the Moors and many others who travelled to India for trade or to conquer and settle down. The earliest marvels of architecture in India are the Hindu and Buddhist caves found in the Sahyadri Mountains, which run down the west coast of India like a green ribbon. In these rocky crevasses, monks, artists and traders carved

9. In 'Life of Mahatma Gandhi' by Louis Fischer
10. About Hindu Scriptures & Ethics on *hinduism.about.com*
11. Gao Xingjian in *Nobel Lecture, 2000*
12. *Vastu shastra* (vāstu śāstra) is a traditional Hindu system of architecture, which literally translates to "science of architecture."
13. The Science of Architecture and Civil Construction was known in Ancient India as *Sthapatya-Shastra.* The word *Sthapatya* is derived from the root word *Sthapana* i.e. 'to establish'.

over 2000 caves, some as temples, some as Buddhist *Viharas*[14], some as Jain monuments and hundreds others as just dwellings or workplaces. The country is dotted with the remains of ages gone by, many world famous like the Taj and Qutab Minar, and some still cloaked in obscurity, off the tourist circuit, waiting to be 'discovered', but architectural gems nevertheless. A sight of these mammoth creations offers a feast to eyes and marvels to the mind. India also has many ancient temples.

Indian dance, music and theatre traditions span back more than 2,000 years. The major classical dance traditions — Bharata Natyam, Kathak, Odissi, Manipuri, Kuchipudi, Mohiniattam and Kathakali. Sir John Marshall, one of the acknowledged authority of the Indus Valley, has said,

"To know Indian art in India alone, is to know but half its story. To apprehend it to the full, we must follow it in the wake of Buddhism, to Central Asia, China, and Japan; we much watch its assuming new forms and breaking new forms and breaking into new beauties as it spread over Tibet and Burma, and Siam; we must gaze in awe at the unexampled grandeur of its creations in Cambodia and Java. In each of these countries, Indian art encounters a different racial genius, a different local environment, and under their modifying influence it takes on a different garb."

The Holy Land

For well over 1,000 years, sacred stories and heroic epics have made up the mythology of Hinduism. Nothing in these complex yet colourful legends is fixed and firm. Pulsing with creation, destruction, love, and war, it shifts and changes. Most myths occur in several different versions, and many characters have multiple roles, identities, and histories. This seeming confusion reflects the richness of a mythology that has expanded and taken on new meanings over the centuries.

India has long been known as a very spiritual, religious heavy area of the world. In India, religion is a way of life. It is an integral part of the entire Indian tradition. For the majority of Indians, religion permeates every aspect of life, from common-place daily chores to education and politics. Hinduism is the dominant faith, practiced by over 80% of the population[15]. Besides Hindus, Muslims are the most prominent religious group and are an essential part of Indian society.

The exact explanation of Hinduism cannot be easily defined. There is no unique philosophy that forms the basis of the faith of the majority of India's population. It cannot be traced to a specific founder nor does it have a "holy book" as a basic scriptural guide. Unlike most other religions, Hinduism does not advocate the worship of one particular deity. One may worship Shiva or Vishnu or Rama or Krishna or some other gods and goddesses or one may believe in the 'Supreme Spirit' or the 'Indestructible Soul' within each individual and still be called a good Hindu. This gives an indication of the kind of contrasts this religion is marked by. At one end of the scale, it is an exploration of the 'Ultimate Reality'; at the other end there are cults that worship spirits, trees and animals. Buddhism, another religion followed in India, originated as an offshoot of Hinduism, but eventually it became popular all over Asia. India gave birth to the some of the world's largest religions: Buddhism, Jainism, Hinduism, and Sikhism. The thousands of rituals and millions of shrines, temples, and other holy places of many faiths defy categorisation here.

14. A Buddhist Temple or a Monestry
15. The Census of India

"No Nation on earth can vie with the Hindus in respect of the great antiquity of their civilization and the antiquity of their religion."[16]

India Today

Standing on the 68th year of India's Independence, she has a lot to say! Her protracted journey has delivered tremendous growth & development accompanied by several remarkable achievements. Indeed, we have made a lot of developments, from launching satellites to green revolution, operation flood to atomic power plants. We have become the fastest growing telecom market, and have achieved self-sufficiency in production.

"We owe a lot to the Indians, who taught us how to count, without which no worthwhile scientific discovery could have been made"

– Albert Einstein[17]

India will still remain an importer and a huge consumer of energy, the needs growing inevitably with the country's growing prosperity.

Time, they say, changes all things. That may be a cliché, but it is certainly a fitting description of what has happened on the international scene over the past couple of decades. With commercial interests ruling foreign policy decisions, Globalisation is continuing relentlessly across nations. India is flexing her economic global presence like never before.

"If I were asked under what sky the human mind has most fully developed some of its choicest gifts, has most deeply pondered on the greatest problems of Life, and has found solutions, I should point out to India."

– Max Mueller[18]

It has become a favourite pastime of analysts to compare India with other developed nations across the globe. India, being a democratic country, every passing Government is trying to add its bit towards the nation's advancement. Each successive Prime Minister is trying to idolise the developed nations of the world.

When India got Independence, our priority was to become a Developed country. However, it seems that our wait in the queue for becoming a developed country keeps on lengthening as many more countries that stood behind us overtook us. Where lays the problem? Why does it take so long for us to become a fully developed country?

The Paradigm Shift

Indian culture has been changing over the past few years due to the threat of western culture. Westernisation is effecting one of the oldest and richest cultures and taking away the traditions, customs, and family values that were once predominant in traditional Indian culture. Modernisation involves a transformation in beliefs about the way the material world functions; westernization requires an alteration in cosmological viewpoints about how one should live their life. Developed by Muslim invasion and European colonization, India's history begins with the Indus Valley Civilisation. Their culture is formed by all different countries and backgrounds. Changes are being made in all areas including religion, dance, and music mostly found in the Bollywood films.

"Without culture, and the relative freedom it implies, society, even when perfect, is but a jungle. This is why any authentic creation is a gift to the future."

– Albert Camus

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16. From the book *Itihasa-The Mystery of His Story in My Story*
17. Albert Einstein, *Vedic Revelations*
18. Max Mueller (German Scholar)

The most important characteristic of a vital culture is a common outlook among the people, who when faced with adversity, difficulty can generate a collective will to action. However, when the collective will to resist adverse circumstances is weak the culture starts decaying.

You might realise that this is what is lacking in India today. We have the Hindus who look up to say Rana Pratap or Guru Gobind Singh for inspiration while Muslims look up to Akbar and Aurangzeb. How then can there be a collective will to face the problems that India is facing today unless common heroes bind us together. Nations are formed through amalgamation of identities and not by harping upon differences continuously.

With the passage of time the environment changes, society-culture come under pressure to respond. When this happens it is up to the best among the dominant minority to adjust their outlook, institutions but under inspiration of its Central Idea. When this does not happen the culture dies and with it the people!

A Need to Transform – From Country to Crown

What are we trying to achieve?

It true that our attitude towards life is now rapidly becoming materialistic. The glamour of the western way of life with its glorification of material prosperity and its wonderful achievements in the field, of science and technology has modified our aim and ambitions. A new orientation has been given to Indian life. The ideal now chiefly adored is success or the ability which produces success. The Quit of success has dazzled our eyes and some of us have started looking down up to the old traditions and culture. The results, however, have not been very happy. We are losing our roots. Blind imitation of the west will just make us get lost in blind alley.

Every day, every hour, every minute, there is an endeavour to achieve national growth, to rise, soar high, create a distinct global identity. The vision is, no doubt, legitimate and robust. However, Is the path chosen, to achieve the errand, an appropriate one? There is no denial, that we have attained unprecedented prosperity down the years. But are we rising by imitating the developed nations? The policies designed by the Government, every year, emulate the activities of the West. There are schemes launched to promote India, to boost the Industrial Growth, mitigate the problems such as poverty shortages, attract foreign Investments etc. All these primarily aim conquering our weaknesses and establishing the Nation's existence, Identity and Integrity across the globe through dedicated and planned development.

"I want to make India a global manufacturing hub. We want to present the world the enormous opportunities that India offers as a base for manufacturing, design, research & development. I would like to give the industry some friendly advice. Don't wait. Don't relax. There are immense opportunities in India."

– Hon'ble Prime Minister, Mr. Narendra Modi

Make in India is an international marketing campaigning slogan coined by Narendra Modi to attract businesses from around the world to invest and manufacture in India. The campaign has been concentrated to fulfil the purpose of Job Creation, Enforcement to Secondary and Tertiary sector, boosting national economy, converting the India to a self-reliant country and to give the Indian economy global recognition[19]. Like, Modi, most of the former Prime Ministers have carried a similar desideratum and mission.

A Change in Perception

My question still remains the same: Why are we trying to achieve what we aren't, rather than cultivating what we already possess? Why are we in a hunt of opportunities rather than first capitalising our strengths? We have entered

19. www.makeinindia.com

the race of advancement, where we are blindly following the footsteps or the approach of our successors. Amidst all this, what has escaped from our memory is the priceless heritage that has been bestowed upon us by our ancestors, with great aspiration. In this expedition, we have forgotten the invaluable wealth that the nation treasures.

"India was the mother of our race and Sanskrit, the mother of Europe's languages. She was the mother of our philosophy, mother through the Arabs, of much of our mathematics, mother through Buddha, of the ideals embodied in Christianity, mother through village communities of Self Government and democracy. Mother India is in many ways the mother of all."

– Will Durant[20]

A student from Pasadena College, California wrote in a letter addressing a renowned University Professor, preaching Hinduism,

"What most people today, at least in the United States, consider an education, I do not…I believe so strongly in the Indian ideals presented in the Bhagavad Gita, Upanishads and Other Vedanta Scriptures. I want a usable, practical, spiritual knowledge, not a degree."

It was India's technicolour canvas of peace, meditation and spirituality that caught the Imagination of Global travellers in that flower-power era.

The charms and graciousness of the Indian way of life endures due to the philosophy of life which we have inherited from the past. Religion in India is not a thing to be put on and put off like Sunday clothes. It permeates the whole fabric of Indian life. Whatever we do, however great or small, is coloured with religious sentiments. From the planting of a tree to the establishing of an industry, all are regarded as pious acts. Training and education, marriage and procreation, birth and death are all tinged with religious fervour.

Indeed, India's unique seven-thousand-year-old recorded history, her millions of Gods and Goddesses, her phenomenal diversity of cultures and gold capped temples, her riot of colours and her blend of religions, capture attention in the highly competitive tourist industry. Hence, efforts should be made, to retain and preserve the inherited treasure that is worth its weight in gold. This is something, that only, we as a nation, have been blessed with. Sustaining our legacy, we can achieve greater bounds and a much faster growth, by promoting its richness and affluence across the sphere. Together, lets focus on what "we are known for" rather than what "we shall be known for".

"When I first visited India, I was stunned by the richness of the land, by its lush beauty and exotic architecture, by its ability to overload the senses with the pure, concentrated intensity of its colours, smells, tastes and sounds. I was as if all my life I had been seeing the world in black and white and when brought face to face with India, experienced everything re-rendered in Brilliant Technicolour"

– Keith Bellows[21]

India – Reshaped by its plush Heritage

"India's rich heritage and culture remains unparalleled, and the country's unity in diversity is still being looked at with awe by the entire world."

– Justice V. Ramasubramanian[22]

The greatness of our culture should be made known to the younger generation. Despite being a plural society with diverse communities, ethnic races and people speaking different languages, democracy remains firm in India. The greatness of India is that though it had encountered invasions, it never went on the offensive and did not invade any part of the world.

"India was the cradle of human race and the birth place of human speech."

– Mark Twain, an American novelist.

20. Will Durant – *The story of Philosophy*
21. From the book *Think India: The Rise of the World's Next Great Power and What It Means for every American*
22. From the book *The Discovery of India.*

India's rich culture and tradition remain an inspiration for the rest of the world. The India of today has a rich past over which we can look back with pride. Our past has given us a definite way of life, which is typically Indian and yet universal in approach.

The most prominent feature of India's culture it that it combines many cultures. India is a land of great variety and many influences have worked to produce modern India. India has shown great capacity for absorbing what came to her from outside.

Throughout her past India has preached and practised toleration and understanding. These have been the basis of Indian religion, philosophy, art and literature. Her sons went far and wide, unmindful of the dangers in their ways, to spread this message of peace. By adopting peaceful means forgetting our independence, Gandhi showed the superiority of peaceful methods over force and violence.

However, we must not also resist the winds of change and remain clinging to the past values and principles of life. We must not close our doors to the influences from the outside world. If those influences are good, they will strengthen the basic concepts of our culture and so enrich it as to make it truly representative of the life of our people.

What is to be avoided is a blind imitation of cultures and values. Countries become great not because they have achieved progress in material things but because they follow noble traditions and base their life on what has been called by Tagore 'Dharma', or a moral way of life. We should remain true to the real genius of our land, the quality and habit of mind which has pre- served us through the ages.

India was a cultural Idea and a vision of vast wealth that lured foreigners, conquerors and travellers to its shoes. Tradition, if followed in the right perspective can never be a hindrance to progress unless orthodoxy creeps in and a person is shackled with obstinacy.

"India is home to 7 great unparalleled traditions: The Spirituality of India, Ayurveda, Indian music, Indian Food, Indian Fabric and Attire, Information Technology and Tourism. These 7 aspects are truly those which India can be proud about. We must honour and develop these 7 aspects. India's economy will then start growing once again."

– Sri Sri

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B.V. Jhaveri, *Advocate*

DIRECT TAXES
Supreme Court

Refundable deposits received by a housing company for allotment of flats and future maintenance is business income. However, share capital received for allotment of flats is a capital receipt and not income. The principles of mutuality does not apply to such transactions

G.S. Homes & Hotels P. Ltd vs. DCIT – Civil Appeal No(s).7379-7380 of 2016 (Arising out of SLP(C) Nos.7857-7858 of 2012, dated 9th August, 2016)

The Karnataka High Court held, following *Shree Nirmal Commercial vs. CIT 193 ITR 694 (Bom.) and 213 ITR 361 (FB)*, that share capital and refundable deposits received by a housing company from its shareholders in consideration of allotting area to them is assessable as business profits. It was also held that the principles of mutuality are not applicable. It was also held that deposits received from the shareholders for future maintenance is assessable as business income. On appeal to the Supreme Court held as under:

> "After hearing the learned counsels for the parties and perusing the relevant material, we modify the order of the High Court by holding that the amount (` 45,84,000/-) on account of share capital received from the various shareholders ought not to have been treated as business income. The High Court, therefore, in our considered view, fell into error in reversing the order of the Tribunal on the aforesaid issue. Insofar as the issue of short-term capital gains with respect to property T1 and T2 and maintenance deposit is concerned, we do not find any infirmity in the order of the High Court so as to require any modification."

Where in view of pending dispute with employees over quantum of bonus, the amount of bonus was paid to the Trust (formed for benefit of employees) and as the dispute was settled well in time the trust paid the bonus amount to employees before the due date, disallowance of the same cannot be made by invoking the provisions of section 40A(9) or section 43B(b). Nor any disallowance can be made for the reason that bonus was not paid by the employer-assessee directly in cash to employees and payment was made to employees by the trust

Shasun Chemicals & Drugs Ltd. vs. Commissioner of Income-tax-II, Chennai [2016] 73 taxmann.com 293 (SC)

1. In the A.Y. 2001-02 the workers of the assessee had raised a dispute of quantum of bonus which had led to the labour unrest as well. Because of this the workers had finally refused to accept the bonus offered to them. Faced with this situation, the assessee had made the payment to the Trust to comply with the requirement of Section 43B of the Act, as the said provision makes it clear that deduction in respect of bonus would be allowed only if actual payment is made. Pertinently, the dispute could be settled with the workers well in time and for that reason payment of bonus was made to the workers on the very next day of deposit of the said amount in the Trust by the assessee. This happened before the expiry of due date by which such payment is supposed to be made in order to claim deduction under section 36 of the Act. However, since the payment was made from the Trust, the Assessing Officer took the view that as the payment is not made by the assessee to the employees directly in cash, it is not allowable in view of the provisions of section 40A(9) of the Act. As pointed out above, though this view was not accepted by the CIT(A) as well as ITAT, the High Court has found justification in the stand taken by the Assessing Officer.

2. Section 40A(9) reads as under:

   "40A(9). No deduction shall be allowed in respect of any sum paid by the assessee as an employer towards the setting up or formation of, or as contribution to, any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860 (21 of 1860), or other institution for any purpose, except where such sum is so paid, for the purposes and to the extent provided by or under clause (iv)[or clause (iva)] or clause (v) of sub-section (1) of section 36, or as required by or under any other law for the time being in force."

3. Their Lordships of the Supreme Court held that the High Court had gone wrong in relying upon the provisions of Section 40A(9) of the Act. This Section deals with deductions in respect of the amount paid by the assessee as an employer towards the setting up or formation of, or as contribution to, any fund, trust, company etc. The condition is that such sum has to be paid for the purpose and to the extent provided by or under clause (iv) or clause (iva) or clause (v) of Sub-section(1) of Section 36. In the present case the assessee company had paid bonus which is not covered by any of the aforesaid clauses of sub-section (1) of section 36 but is allowable as deduction under clause (ii) of sub-section (1) of Section 36. Therefore, section 40A(9) has no application. Insofar as the provisions of Section 43B are concerned, they are also not applicable inasmuch as clause (b) of Section 43B refers to the sum payable by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees. Thus, this provision also does not mention about bonus. The provisions of section 36 which enumerate various kinds of expenses which are allowable as deduction while computing the business income under section 28 of the Act. The amount paid by way of bonus is one such expenditure which is allowable under clause (ii) of sub-section (1) of section 36. There is no dispute that this amount was paid by the assessee to its employees within the stipulated time. Embargo specified under section 43B or 40A(9) of the Act does not come in the way of the assessee. Therefore, the High Court was wrong in disallowing this expenditure as deduction while computing the business income of the assessee and the decision of the ITAT was correct.

Jitendra Singh & Sameer Dalal
Advocates

DIGEST OF CASE LAWS
Tribunal

1. Business expenditure – Disallowance – Section 14A of the Income-tax Act, 1961 – There could be no disallowance of expenses under section 14A of the Act, where assessee had not earned any tax free income during relevant year. A.Y. 2009-10

Raniganj Co-operative Bank Ltd. vs. Dy. CIT – [ITA No. 1984 / Kol. / 2014; Order dated 2-9-2016; Kolkata Bench]

For the year under consideration there was no exempt dividend income earned by the assessee. The AO however, invoked provisions of Section 14A of the Act and made a disallowance by applying the formula prescribed in Rules 8D(2)(ii) and (iii) of the Income tax Rules, 1962. The A.O. was of the opinion that even in the absence of exempt income disallowance under Section 14A of the Act can be made relying upon the decision of the Special Bench of the ITAT in the case of, *Cheminvest vs. ITO [121 ITD 318 (Del.)(SB)]*

On appeal the Tribunal held that provisions of Section 14A of the Act are applicable only when any part of the income is not to be included in the total income of the assessee and the expenditure relating to that part of income is claimed by the assessee as deduction.

2. Cash credit – Section 68 of the Income-tax Act, 1961 – Assessee was not maintaining any account books – Assessing Officer examined Bank Pass Book of assessee and treated cash deposits in bank account as unexplained cash credit within meaning of section 68 of the Act – Held as Bank Pass Book could not be construed to be a book maintained by assessee for any previous year provisions of section 68 of the Act was not applicable. A.Y. 2011-12

Smt. Manasi Mahendra Pitkar vs. ITO – [I.T.A. Nos. 4223 & 4224 / M / 2015; Order dated 12-8-2016; Mumbai Bench]

The A.O. while examining the Bank Pass Book of the assessee noted that during the year cash amounting to ` 29 lakhs was deposited on various dates in a bank account held by the assessee. Accordingly, the

A.O. directed the assessee to explain the nature and source of the cash deposits. Not satisfied with the with explanation of the assessee, the A.O. treated the entire cash deposits in the bank account as unexplained cash credit under section 68 of the Act. The CIT(A) gave partial relief to the assessee.

On appeal before the Tribunal the assessee contended that the Bank Pass Book was not the books of account maintained by her so as to fall within the ambit of section 68 of the Act. Relying upon the decision of, *CIT vs. Bhaichand Gandhi - [(1993) 141 ITR 67 (Bom.)]* it was argued that under section 68 of the Act, it is only when an amount is found credited in the books of account of the assessee for any previous year, that the deeming provisions of section 68 of the Act would apply.

The Tribunal noted that the assessee was not maintaining any books of account and section 68 of the Act has been invoked by the A.O. merely on the basis of the Bank Pass Book. The Tribunal following the decision in the case of Bhaichand Gandhi (supra) concluded that Bank Pass Book or Bank Statement cannot be construed to be a books maintained by the assessee for any previous year. Thus, the Tribunal held that the addition made by the A.O. under section 68 of the Act was not sustainable.

3. Charitable purpose – Medical relief – Section 2(15) of the Income-tax Act, 1961 – Assessee a registered society under section 12A of the Act – Object of assessee was to provide for research and running of veterinary hospitals and veterinary help to cattle owners for improving livestock health – The assessee collected cess from milk producers members for providing them research, animal nursery, fertility, and other facilities – The Assessing Officer invoking proviso to section 2(15) and denied exemption of income claimed by assessee – Held term 'medical relief' as mentioned in section 2(15) also includes relief made available by assessee to animals in lieu of a nominal cess thus, assessee could not be regarded as an entity advancing any other object of general public utility covered by proviso to section 2(15). A.Y. 2010-11

Amul Research & Development Association vs. ITO – [ITA No.: 3032 / Ahd / 2013; Order dated 18-8-2016; Ahmedabad Bench]

The assessee was a registered society under section 12A of the Act. The main object of assessee was to provide for research, establishment and running of veterinary hospitals, laboratory services and provide veterinary help to cattle owners for improving health of livestock. The assessee collected a nominal cess from milk producers members in lieu of providing them research, animal nursery and other improvement facilities. The A.O. took a view that aforesaid activities carried out by assessee were in the nature of trade, commerce or business including profit motive. Thus, invoking the proviso to section 2(15) of the Act he denied exemption of income as claimed by assessee under section 11(1) of the Act. The CIT(A) confirmed the order of the A.O.

On appeal Tribunal setting aside the order of the A.O. held that the assessee's activities in making available the facilities in question to milching animals are to ensure that they are free from diseases, their breed improvement and overall well being. Article 51(g) of Constitution of India prescribes to have compassion for living creatures. As neither the Constitution nor the Act contains any specific distinction between living beings for the purpose of providing medical relief to humans or animals. Thus, the Tribunal held that assessee's activities deserve to be treated under a specific category of 'medical relief' not covered by section 2(15) proviso of the Act inserted with effect from 1-4-2009.

4. Income from House Property – Section 22 read with section 27(iiib) of the Income-tax Act, 1961 – Assessee was only a licensee of premises – Provisions of section 22 read with section 27(iiib) were not attracted – Income assessable under the head 'Income from Business or Profession' and not 'Income from House Property'. A.Ys. 2006-07 & 2007-08

Bombay Plaza (P.) Ltd. vs. Asstt. CIT – [ITA Nos.: 1641 & 1203 / Kol. / 2014; Order dated 2-9-2016; Kolkata Bench]

The assessee acquired commercial premises under a leave and licence agreement for a long period at a monthly licence fee. After acquiring the premises certain portions of the commercial space was sub-let to various parties who were interested in setting up shops. As commercial spaces were sub-let on licence basis along with various services, the consideration received therefrom by the assessee was offer as business income.

The A.O. treated the assessee as deemed owner of the premises as per the provisions of section 27(iii) (b) of the Act and computed the income of the assessee under the head 'Income from House Property'.

On appeal Tribunal held that the assessee was merely a licensee of the premises which was owned by a third party. The assessee and the owner of the premises intended it to be licence and the agreement did not create an interest in the property owned by the licensor and that the licensee (assessee) did not have exclusive possession of the property. As the assessee was merely a licensee, the provisions of section.22 read with section 27(iiib) of the Act were not attracted. Thus, as the assessee carried on a systematic and regular activity in the nature of business, the income received by it from granting the premises on sub-license was to be assessed under the head Income from Business and was not assessable under the head 'Income from House Property'.

CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION
Case Law Update

A. AUTHORITY FOR ADVANCE RULINGS

1) Where majority of the decisions of the Board of Directors of the Applicant were taken in Mauritius, the Applicant could not be said to have been wholly controlled and managed in India under Section 6(3) of the Income-tax Act, 1961.

Mahindra BT Investment – TS-479-AAR-2016

Facts

1. The applicant, a company incorporated in Mauritius viz. Mahindra BT Investment Company (Mauritius) Ltd, is held by Mahindra Overseas Investment Co. (Mauritius) Ltd., Mauritius and BT Holding Ltd., UK in the ratio of 57 per cent and 43 per cent of total share capital, respectively. The control and management of the affairs of the Applicant is exercised by its Board of Directors which comprises of three Directors resident in Mauritius, one director resident in the UK and one director resident in India. All the meetings of the Board are conducted in and chaired from Mauritius.

2. The Applicant had acquired 9,931,638 shares in Tech Mahindra Ltd. ('TML'), India, a company listed on the Bombay Stock Exchange and National Stock Exchange. Subsequently, on May 10, 2005, the Applicant, AT&T International Inc (AT&T), Mahindra and Mahindra Ltd. (M&M) and British Telecommunications ('BT') entered into an Options agreement pursuant to which AT&T was given the option to purchase the shares held by the Applicant in TML on achieving certain milestones stipulated in the Agreement. AT&T achieved the said milestones and chose to exercise the option pursuant to which the Applicant transferred 98,70,912 shares of TML to AT&T which led to a long-term capital gain of ` 90 crores. Consequently, the Applicant approached the Authority for Advance Rulings with the following questions:

Whether the Applicant, a tax resident of Mauritius, was chargeable to capital gains tax under Article 13(4) of the India-Mauritius DTAA in respect of the transfer of 9,870,912 shares of TML to AT&T? and

In the event of the answer to the aforesaid question being in the negative, whether the Applicant would be chargeable to tax at 10 per cent under section 112(1) of the Income-tax Act, 1961 ('the Act')?

Ruling

1. The Authority for Advance Ruling ('AAR') dismissed the contention of the Revenue that the real transaction was actually between TML and AT&T and that the Applicant was incorporated

into the said transaction merely to claim the benefit of Article 13(4) of the India-Mauritius DTAA and that the Applicant was not set up for a commercial purpose, noting that the Options Agreement entered into between TML, AT&T and the Applicant provided AT&T with the opportunity to become a shareholder of TML only if AT&T had had given certain level of business to TML and that there was nothing unusual or abnormal about the conditions in the said Agreement.

2. Further, the AAR rejected the contentions of the Department viz. (i) that the effective place of control and management of the Applicant under section 6(3) of the Act was in India and (ii) that in light of Article 4(3) of the India-Mauritius DTAA, which provides that a resident of both the contracting states would be deemed to be a resident of the contracting state in which its place of effective management is situated and therefore the capital gains would be taxable in India. It noted that a large number of decisions of the Board of Directors of the Applicant were taken in Mauritius and therefore it was incorrect to contend that the control and management of the Applicant was wholly in India and therefore the conditions under section 6(3) of the Act were not attracted.

3. Accordingly, it held that there would be no capital gains tax since the capital gains was exempt under Article 13(4) of the India Mauritius DTAA.

2) Consideration for educational activities/training programmes not be considered as Fees for Included Services under the India–USA DTAA. Applicant incorporated as a non-profit corporation can not be said to be carrying out any business and since there was no fixed place of business in India – Hence no PE existed in India

The Regents of the University of California – TS-490-AAR-2016

Facts

1. The Applicant, the Regents of the University of California, a non-profit public benefit corporation formed for the purpose of providing education, had entered into an agreement with Northwest Universal Education Pvt. Ltd. pursuant to which it agreed to launch a Management programme for a duration of 60 days which would train senior executives of companies/corporations, working in India, having a minimum working experience of 8 years. Northwest was to arrange the place for conducting these programmes in India.

2. The Applicant raised the following queries before the AAR:

Whether the programme fee received by the Applicant was chargeable to tax as fees for included services within the meaning of the said term under Article 12 of the India-US DTAA and/or provisions of section 9(1)(vii) of the Act and therefore subject to withholding tax under section 195?

Whether the activities undertaken by the Applicant in India viz. teaching for 7 days would constitute a Permanent Establishment in India in terms of Article 5 of the India-US DTAA?

Ruling

1. The AAR noted that the Revenue did not have any objection to the fact that the activity of the assessee was in the nature of educational activity and therefore could not be taxed as Fees for Included Services as it was directly covered under Article 12(5)(C) of the India-USA DTAA.

2. As regards the issue of Permanent Establishment, the AAR held that the nature of activity carried on by the Applicant was educational in nature and could not be treated as a business activity particularly because the Applicant was registered as a non-profit public benefit corporation and therefore the income earned by it could not be treated as business income under Article 7. Further, it held there could not be a PE under Article 5 of the India-

USA DTAA since every time a programme was undertaken in India, Northwest arranged for a temporary place and therefore the same could not be treated as a fixed place PE.

3) Where a composite agreement for offshore supply of goods and installation services was entered, without any explicit bifurcation of the two, the entire fee received under the agreement was attributable to the project office and therefore taxable in India.

MERO Asia Pacific Pte. Ltd. – TS-489-AAR-2016

Facts

1. The Applicant, a company registered under the laws of Singapore and was engaged in the business of executing contracts in relation to structural glazing and wall cladding works. It had set up project offices in India for the purpose of executing the contract works awarded to the company. Delhi International Airport Pvt. Ltd. had awarded a contract for the development of the Delhi Airport to L&T which was in turn awarded to the Applicant (for external and internal façade for glazing and cladding systems for piers, fixed link bridges and nodes) pursuant to an Agreement between the two.

2. The Applicant filed an application before the AAR submitting that the scope of its work could be broadly divided into offshore supply of goods and installation and other works to be executed in the airport and that since the contract was an offshore supply contract, the title of which was passed to L&T offshore, the payment of which was received in Singapore and for which the negotiation and supply of materials was also sourced from outside India, no income was attributable to India. Further, it contended that no income could be attributed to the Project Office in India since profits earned by way of offshore supplies were not directly or indirectly attributable to the PE and that the Project Office merely oversaw the installation work which was independent of the supply.

3. It raised the following questions before the AAR:

On the facts and circumstances of the case, whether amount received by the applicant from L&T towards offshore supply of goods and materials were liable to tax in India under the Act and the India-Singapore DTAA? And

If the answer to the question above was in the affirmative, then to what extent are the amount reasonably attributable to the operations carried out in India?

Ruling

1. The AAR noted that there was only one contract agreement entered into by the Applicant and that the same could not by artificially bifurcated into supplies affected and installation services rendered since the agreement did not provide for such bifurcation.

2. It rejected the contention of the Applicant that the profits could not be attributable to the PE in India and clarified that the PE in the form of the Project Office had come into existence long before the design of materials and equipment for offshore supply started and also noted that the goods were cleared from customs in India by the project office for which the Project office paid customs duty. Accordingly, it held that it was incorrect to say that the PE had no role in respect of the supply of goods and material. It further clarified that even though the sale was concluded outside India, the Applicant was responsible for the installation work in India at its own cost which was carried out by the Project Office.

3. Applying the intention principle under the Sales of Goods Act, the AAR concluded that in the present case the goods of the Applicant would pass only when the installation and erection of entire works was completed and held that the present contract was clearly a composite contract for providing services. Accordingly, it held that the entire amount received from L&T was taxable in India.

4) In the absence of any consideration, the notional market value could not be taken as consideration and there would be no capital gains chargeable to tax pursuant to a scheme of amalgamation. The benefit of section 47(vi) of the Act would be available to the assessee in light of the non-discrimination clause of the India-Italy DTAA

Banca Sella SPA – TS-468-AAR-2016

Facts

1. The Applicant, a banking company viz. Banca Sella SPA, a wholly owned subsidiary of Banca Sella Holding SPA, Italy was engaged in the business of collection of savings and providing credit in Italy and abroad. It also proposed to provide outsourcing services, banking and financial services and other ancillary services. Sella Servizi Bancari SCPA ('SSBS') was one of the Group companies of the Banca Sella Group ('the Group') which rendered services relevant for the operational activities of the Group. The Applicant held 15 per cent stake in SSBS. The Applicant proposed to amalgamate with SSBS, pursuant to which it would be the amalgamated company. The Group had also been carrying out business in India through a company called SSIPL which was engaged in providing IT services to the other Group entities. Subsequently, SSBS incorporated a branch in India which took over the business of SSIPL in a slump sale for which SSIPL paid capital gains tax.

2. In light of the amalgamation scheme proposed to be implemented by the Group, the Applicant has raised the following questions before the AAR:

- Whether capital gains accruing to SSBS on the transfer of its Indian branch as a consequence of amalgamation would be taxable in India?
- Assuming that it was taxable in India, whether by virtue of the non-discrimination clause under Article 25 of the India-Italy DTAA, the exemption under section 47(vi) was available to it?
- Whether capital gains accruing to the Applicant and other shareholders from the extinguishment of their shares held in SSBS was taxable in India?
- Whether the transaction would attract the transfer pricing provisions?

Ruling

1. As regards the capital gains accruing to SSBS on the transfer of its Indian branch, the AAR held that in the absence of any consideration arising out of such transfer, the notional market value of SSIPL could not be treated as consideration in the hands of SSBS which did not receive any consideration before it merged and therefore as per the decision of the Apex Court in the case of *CIT vs. BC Srinivas Setty [(1981) 128 ITR 294 (SC)],* the same was not taxable as capital gains. Further, it held that the benefit of the non-discrimination clause contained in Article 25 of the India-Italy DTAA was available to the Applicant and that the contention of the Revenue seeking to deny the same on the basis of Article 25(3) was not applicable as Article 25(3) provided an exception only in cases of personal allowances, reliefs, reduction and since section 47(vi) provided benefit to companies in an amalgamation, the said exception could not be denied to the Applicant.

2. With respect to the capital gains in the hands of the Applicant on extinguishment of shares held in SSBS, the AAR held that the said extinguishment was a transfer as per section 2(47) of the Act, and that as per section 5(2) read with Explanation 5 to section 9(1)(i) of the Act, gains arising therefrom would be taxable in India, however, since there was no consideration accruing to the Applicant in the instant case,

there would be no capital gains chargeable to tax in the hands of the Applicant.

As regards the other shareholders to whom consideration accrued, the AAR held that as per Article 14(5) of the India-Italy DTAA, the gains would be taxable only in Italy and therefore not chargeable to tax in India.

3. The AAR further held that the Transfer Pricing provisions would not be applicable where there was no chargeability to tax.

5) Capital gains arising to Mauritian company on transfer of shares of an Indian asset management and trustee company not taxable under Article 13 of the India-Mauritius DTAA. Mere presence of the holding company in the Share Purchase agreement for transfer of shares in the capacity of sponsor of the said company, would not imply that the Applicant was a permitted transferee.

Shinsei Investment I Ltd. – TS-473-AAR-2016

Facts

1. The Applicant, incorporated in Mauritius, as a wholly owned subsidiary of Shinsei Bank Ltd., Japan which is listed on the Tokyo Stock Exchange, holds a valid Tax Residency Certificate issued by the Mauritian Revenue authorities and does not have a permanent establishment in India. The Applicant owned 75 per cent of the total paid-up capital of Shinsei Asset Management Co. Pvt. Ltd. ('Shinsei AMC') and 99.99 per cent of the total paid-up capital of Shinsei Trustee Company India Pvt. Ltd. ('Shinsei Trustee'). Shinsei AMC and Shinsei Trustee are the asset management and trustee company respectively of Shinsei Mutual Fund and Shinsei Bank was its sponsor. A Share Purchase Agreement was entered into between the Applicant, Shinsei Investment II Ltd., Shinsei Bank, Mr. Raksesh Jhunjunwala, Freedom Financial Services Pvt. Ltd., Daiwa Securities Group Inc, Shinsei AMC and Shinsei Trustee to sell its entire shareholder in Shinsei AMC and Shinsei Trustree to Daiwa and its affiliates.

2. The Applicant raised the following questions before the AAR:

- Based on the facts and circumstances of the case and in law, whether the Applicant is liable to tax in India in respect of the transfer of shares in Shinsei AMC and Shinsei Trustee under the India-Mauritius DTAA?
- Whether Daiwa and its affiliates would be required to withhold tax as per section 195 of the Act from payments made to the applicant?
- Whether the Applicant would be required to file an income-tax return in India as per section 139, if the capital gains were not taxable in India?
- Whether the Applicant would be liable to tax under the provisions of section 115JB of the Act?

3. The Revenue contended that the Applicant was a permitted transferee and that the parent company i.e. Shinsei Bank Ltd. held all the rights and obligations in respect of the transaction and that the Applicant did not have the rights / responsibilities in respect of share sale that Shinsei Bank Ltd did. It contended that Shinsei Bank has the sole responsibility for the conduct of the transaction and the Applicant was a mere nominee shareholder and therefore the benefit of the India-Mauritius DTAA was not to be granted to the Applicant.

Ruling

1. The AAR noted that the Applicant's parent company was the sponsor of the Mutual fund and was party to the said Share Purchase agreement in the capacity of a sponsor as it was to transfer its sponsorship to the new sponsor i.e. Daiwa Asset Management Company Ltd. It held

that the Applicant had paid for the shares and made its investments on its own and therefore it could not be treated as a permitted transferee. Accordingly, it held that the Applicant being a resident of Mauritius, having a valid tax residency certificate was eligible to the benefits of Article 13(4) of the India–Mauritius DTAA, pursuant to which the capital gains arising from transfer of shares would not be liable to capital gains tax in India.

6) Service fee payable by the Applicant to its Russian subsidiary for providing product promotion services was not FTS under the Act or under Article 12 of the India-Russia DTAA

Dr. Reddy Laboratories Ltd. – TS-487-AAR-2016

Facts

1. The Applicant, Dr. Reddy's Laboratories Ltd., a pharmaceutical company proposed to enter into a Service Agreement with its subsidiary DRL Russia to avail of product promotion services in order to promote in Russia and develop a local brand plan for the same.

2. The Applicant approached the AAR for a ruling on the following questions:

- Whether, on facts and circumstances of the case, the service fee payable by the Applicant to DRL Russia under the Service agreement would be regarded as Fees for Technical Services under section 9(1)(vii) of the Act, warranting withholding of tax at source under section 195 of the Act?
- Whether on the facts and circumstances of the case, the service fee payable under the Service agreement would be regarded as fees for technical services under Article 12 of the India-Russia DTAA?
- If the answers to the aforesaid questions were in the negative whether the service fee payable by the Applicant to DRL Russia was taxable in India under Article 7 of the India-Russia DTAA?
- If the answers to the aforesaid Questions were in the negative, whether on the facts and circumstances of the case, the service fee payable by the Applicant to DRL Russia was taxable under Article 22 of the India-Russia DTAA?

Ruling

1. The AAR noted that the definition of FTS under the India-Russia DTAA was similar to the definition of FTS under section 9(1)(vii) of the Act and considered the contention of the Applicant that the medical representatives of DRL Russia merely promote the goods by way of meeting doctors and pharmacies and their activities were executory in nature since such services do not entail the rendering of services to the Applicant. The AAR dismissed the contention of the Department, that DRL Russia's market research team had prepared reports utilising technical knowledge which were utilised by the Applicant for its brand promotion, since there was no evidence to prove the same and the contentions of the Department were merely based on assumptions. It further noted that the reports prepared by DRL Russia in respect of the Agreement were merely statistical in nature and did not support the contention of the Department. Additionally, it also dismissed the contention of the Department that the said services were managerial since the job of the medical representatives were to merely meet doctors and pharmacies and could not be said to be managing the affairs of DRL India in Russia. Accordingly, it held that the services could not be considered as FTS under the Act or DTAA.

2. Since the AAR held that the amount paid was not in the nature of FTS under the Act or Article 12 of the India-Russia DTAA, it did not rule on the other questions raised by the assessee.

B. HIGH COURT

7) Plantation/farm of assessee situated in Malaysia would be a permanent establishment

Satpuda Tapi Parisar Sahakari Sakhar Karkhana Ltd. vs. DCIT – TS-517-HC-2016 (Bom.) – TP

Facts

1. The assessee filed its return for AYs 2005-06 & AY 2006-07 which was processed under under section 143(1) of the Act. The Assessing Officer ('AO') issued notices under 148 of the Act stating that income chargeable to tax had escaped assessment since the assessee did not offer its income from its plantation in Malaysia to tax in India when its affairs were controlled in India. The assessee contended that the said income was not chargeable to tax in India considering (a) the income from the plantation was income derived from an immovable property in Malaysia and that the planation constituted a Permanent Establishment under the DTAA. The AO issued an order under section 147, read with section 143(3) of the Act assessing the impugned income to tax in the hands of the assessee.

2. Aggrieved, the assessee filed an appeal before the CIT(A) wherein the CIT(A) deleted the addition made by the AO, ruling in favour of the assessee.

3. The Revenue filed an appeal before the Hon'ble Tribunal, wherein the Tribunal held in favour of the assessee.

Judgment

1. The Court on examining Article 5(2) of India-Malaysia DTAA, held that the assessee's plantation constituted a permanent establishment in Malaysia and therefore the income arising therefrom would be taxable only in Malaysia and not in India.

8) Where the assessee was taxed on its shipping income in Singapore on accrual basis but the amounts were remitted to London, Article 24 of the India-Singapore DTAA would not apply and the benefit of Article 8 could not be denied on the basis of Article 24 of the India-Singapore DTAA which restricts benefit to the income remitted to Singapore

MT Maersk Mikage vs. DIT (IT) – TS-474-HC-2016 (Guj.)

Facts

1. The assessee, a Singapore based company was engaged in the business of providing shipping agency services. It had, through ships owned by it, undertaken voyages from various Indian Ports and earned income from exporters. While filing its return under section 172(3) of the Act, the assessee declared Nil income by relying on Article 8 of the India-Singapore DTAA claiming that the said income was only taxable in Singapore and not under the Act.

2. Since the freight received was remitted to London and not Singapore, the AO denied the Treaty benefit and held that the said freight receipt was taxable in India in light of Article 24 which provides that the benefit of any other Article of the India-Singapore DTAA would be with respect to the amounts remitted or received in Singapore.

3. The assessee filed a revision petition under section 264 of the Act and submitted a certificate issued by the Inland Revenue Authority of Singapore wherein it was certified that the full amount of income in question was assessable to tax in Singapore on accrual basis and not on the basis of remittance received. The assessee further contended that the limitation provided by Article 24 of the India-Singapore DTAA would not apply. However, the Commissioner rejected the Petition.

4. Accordingly, the assessee filed a Writ Petition before the Hon'ble High Court.

Judgment

1. The Court held that the limitation of benefit under Article 24 of the India-Singapore DTAA would assume significance only if the income being taxed under any of the Articles of the DTAA were taxed with regard to income received/remitted. Noting the submissions of the assessee and the certificate issued by the Inland Revenue Authority of Singapore relied on by the assessee, it held that the said income was taxed on accrual basis and not on the basis of income remitted and therefore the fact that the amounts were remitted to London would be of no significance.

2. Accordingly, it held that the assessee was entitled to the benefit of Article 8 of the India-Singapore DTAA.

9) Penalty under Explanation 7 to section 271(1)(c) of the Act could not be imposed merely because the TPO rejected 9 out of 12 comparable companies selected by the assessee in its TP study as there was no overt act or suppression of income and the rejection of comparable companies was not foreseeable

Pr CIT vs. Verizon India Pvt. Ltd. – TS-698-HC-2016 (Del.) - TP

Facts

1. The assessee, was engaged in providing business services to its AEs for AY 2007-08. During the relevant year, the assessee had in the course of its transfer pricing proceedings, relied on twelve comparable companies out of which the TPO had rejected 9 of them and determined ALP on the basis of the remaining comparable data. The AO was of the view that as per Explanation 7 to section 271(1)(c) the addition was deemed to represent income and therefore imposed consequential penalty. The order of the AO was set aside by the Tribunal.

2. Aggrieved, the Revenue preferred an appeal before the Hon'ble High Court.

Judgment

1. The Court noting that there was a delay of 550 days in filing of appeal dismissed the appeal of the Revenue.

2. Notwithstanding the delay, the Court held that even on merits no penalty could be imposed on the assessee. It held that the assessee in this case could not have visualised that out of 12 comparable companies furnished, the TPO would have rejected 9 and that the matrix of calculations would have undergone such a radical change. It also observed that some of the comparable companies rejected by the TPO had been accepted as comparable for the previous year. Noting that there was no overt act, which disclosed conscious and material suppression it held that Explanation 7 to section 271(1)(c) could not be invoked in a blanket manner as it would be injurious to the assessee as well as contrary to the purpose for which it was introduced into the statute.

10) Cost of manufacture and export of goods of third parties was not to be included in the PLI of the assessee and only those costs incurred by the assessee in its capacity of providing buying services were to be considered in the cost base

Pr. CIT vs. Li & Fung (India) Pvt. Ltd. – TS-686-HC-2016 (Del.) - TP

Facts

1. The assessee was engaged in the business of providing buying services to its AEs and was paid service changes for such services at cost plus markup. The Tribunal following the decision of the Court on the same issue for the previous year, held the denominator for the purpose of computing the Profit Level Indicator of the assessee was to be the total costs incurred by the assessee and not on the FOB cost of goods / cost of goods sourced from third party vendors in India viz. the cost of manufacture and export of finished goods/ready-made garments by third

parties.

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

Judgment

1. The Court followed the decision of the co-ordinate bench in the prior year wherein it was held that the assessee's compensation model was based on the 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 the assessee's net profit margin realised from international transactions had to be calculated only with the reference to cost incurred by it and not by any other entity, either third party vendors or the AE.

2. It held that the TPO's reasoning to enhance the assessee's cost base by considering the cost of manufacture and export of finished goods i.e. ready-made garments by the third party vendors (which cost is certainly not the cost incurred by the assessee) is nowhere supported by the TNMM under Rule 10B(1)(e) of the Rules. Accordingly, the appeal of the Revenue was dismissed.

11) Companies outsourcing their activities, providing geospatial services and having substantially lower turnover could not be compared to the assessee who was engaged in IT enabled services. Further, companies having export to sales of 74.45 per cent could not be excluded as comparable merely because there was a difference of 0.55 per cent in the export filter

CIT vs. Mercer Consulting (India) Pvt. Ltd. – TS-664-HC-2016 (P&H) – TP

Facts

1. The assessee, a wholly owned subsidiary of Mercer Mauritius Ltd. was engaged in providing IT and IT Enabled Services to its AE for which it was compensated on a cost plus basis. During the relevant year, the assessee reported three international transactions with its AEs for which it used TNMM as the most appropriate method. The TPO carried out its own analysis and arrived at an upward adjustment of ` 6.16 crore. The assessee filed objections before the DRP contesting the selection / non consideration of 5 companies viz. Allsec Technologies, Cosmic Global Ltd. Genesys International Corporation Ltd., R Systems International Ltd. & Coral Hub Ltd. without any relief.

2. Aggrieved, the assessee filed an appeal before the Tribunal wherein the assessee's appeal was allowed.

3. Accordingly, the Department filed appeal before the Hon'ble High Court

Judgment

1. The Court held that the TPO was incorrect in excluding Allsec Technologies Ltd on the ground that its export to sales filter amounted to 74.45 per cent as against the 75 per cent filter adopted. It upheld the order of the Tribunal wherein it was held that a company could not be excluded as comparable merely because of a deviation of 0.55 per cent. It held that there was nothing sacrosanct about the 75 per cent filter and therefore held that the said company was wrongly excluded by the TPO.

2. As regards Cosmic Global Ltd., it held that since the turnover of the said company from BPO services was only ` 27.76 lakhs as opposed to the assessee's revenue of ` 59 crore, the said company could not be considered as comparable.

3. The Court held that Genesys International Corporation Ltd. could not be considered as comparable to the assessee since the said company provided full range of geospatial services which was not comparable to the services provided by the assessee. Accordingly, it held that the same was to be excluded as comparable.

4. The Court upheld the order of the Tribunal, wherein R Systems International Ltd. was included as a comparable despite having a different financial year ending. It held that where despite difference in financial years between the assessee and a comparable if it was possible to determine the value of international transactions during the corresponding periods, the purpose of comparability would be served.

5. With respect to Coral Hubs Ltd., the Court dismissed the contention of the Department that the said company could not be argued by the assessee since it was included by the assessee as a comparable in its TP study. On merits, it held that the company was not functionally comparable to the assessee since it outsourced a significant part of its work. It held that there could be no comparison between an enterprise that conducts its business activities itself with one that outsources its activities to a third party.

6. Accordingly, the addition made by the TPO was deleted.

C) TRIBUNAL DECISIONS

12) Whether payments made to non-residents for AMC services do not constitute FTS both under the Act and the tax treaty, since these services were in the nature of routine repairs and maintenance – Held: Yes; in favour of the assessee

ACIT vs. M/s. HCL Comnet Ltd. 2016-TII-195-ITAT-DEL-INTL / TS-456-ITAT-2016 (Del.)

Assessment Years: 2004-05, 2006-07 & 2009-10

Facts

1. The assessee was engaged in the business of designing, delivering, installation and commissioning of networking solutions, and providing professional services for management and maintenance of networking solutions.

2. The assessee filed its return of income for the assessment year (AY) 2004-05, and the assessment was completed under section 143(3) of the Act. Later, the Commissioner of Income-tax (CIT), in exercise of his revisionary powers under section 263, passed an order setting aside the assessment, *inter alia*, on the grounds that the Tax Officer (AO) had not verified allowability of the assessee's payments to non-residents towards AMC services of equipment, in respect of which no tax was deducted at source. The Tribunal, *vide* its order dated 8th October, 2010, upheld the validity of the CIT's revision order .

3. The assessee submitted in the proceedings before the AO that:

a) Payments for AMC services had been made to various parties belonging to different countries

b) The AMC services comprised of payment for warranty charges and extended warranty charges, which were in the nature of repair / replacement of equipment; and

c) As per the AMC contract, the equipment was sent outside India for any repair / replacement and was re-imported into India after being repaired.

4. Since the payments were made to non-residents for AMC services, the TO disallowed them under section 40(a)(i) of the Act as no tax had been deducted at source from the payments.

5. The Commissioner of Income-tax (Appeals) [CIT(A)] allowed the assessee's appeal by holding that payments made to non-residents towards AMC payments were not taxable in India since:

a) The AMC payments were not in the nature of FTS;

b) The AMC payments were in the nature of business income of the non-residents and, since they did not have a PE in India, the same would not be subject to tax in India;

c) AMC payments were not subject to deduction of tax at source under section 195 of the Act, and consequently, the question of disallowing the payment under section 40(a)(i) did not arise.

Decision

The Tribunal held in favour of the assessee as under:

1. The assessee reiterated the submissions made before the CIT(A), as under:

a) The TO had disallowed the entire AMC payments merely on the premise that since payments were made to non-residents, tax was required to be deducted at source, without analysing the taxability of the AMC payments under the Act and the tax treaty between India and the respective foreign countries.

b) Tax had to be deducted under section 195 of the Act only if a payment was chargeable to tax in the hands of non-residents under the Act. In support of its contention, the assessee relied on the Supreme Court's (SC) judgment in the case of *GE India Technology Centre (P) Ltd. vs. CIT (327 ITR 456)(SC).*

c) The assessee referred to the AMC contract entered into with a non-resident (an Israeli company) and submitted that the AMC services were in the nature of routine repairs and maintenance, and were provided outside India. The AMC payments did not constitute FTS under section 9(1)(vii) of the Act as there was no technical, managerial or consultancy services provided by the non-resident to the assessee. Reliance was placed on the Delhi Tribunal decision in *Lufthansa Cargo India (P.) Ltd. vs. DCIT (91 ITD 133(Del.)).*

d) The AMC service did not make available any technical knowledge, skill, experience, know-how, etc., to the assessee or its employees, and therefore the payment for the said services was not taxable as FTS under Article 13(3) of the tax treaty between India and Israel. Consequently, the assessee submitted that the assessee had no liability to withhold tax under section 195 of the Act.

2. The Revenue contended that the CIT(A) was not right in holding that the services were rendered outside India, since the equipment was in India, and the services were provided through communication in India. The Revenue also relied on the covenant in the AMC contract wherein it was stated that in respect of the repaired equipment, the CIF destination was Mumbai, and therefore such payments would be taxable in India.

3. The Tribunal upheld the CIT(A)'s order, and held that AMC services provided by the non-resident did not constitute FTS either under section 9(1)(vii) of the Act or under the tax treaty.

4. The Tribunal analysed the AMC contract entered into by the assessee with one company, and came to the following conclusions:

a) The primary purpose of the AMC contract was provision of annual maintenance services;

b) The Revenue's contention that the services were rendered in India was incorrect, since equipment was sent outside India to the non-resident for repair / replacement, and thereafter, repaired equipment was re-imported into India. Therefore, it could not be held that the services were performed in India;

c) The Revenue had not challenged the point whether the non-resident payees had a PE in India, and therefore, the business income earned by the non-resident payees would not be taxable in India.

13) India-China DTAA – Article 15 – Whether salary received in India by a non-resident for services rendered

outside India is not eligible for exemption under the tax treaty – Held: Yes; in favour of the Revenue

Shri Swaminathan Ravichandran vs. ITO 2016-TII-189-ITAT-MAD-INTL

Assessment Year: 2011-12

Facts

1. The assessee had received the salary in India for the services rendered in China. As the salary was paid in India for the entire financial year (FY), the Indian employer had deducted tax at source on such salary payment.

2. During the relevant FY, the assessee qualified as a tax resident of China and a non-resident of India for the FY 2010-11.

3. As per Article 15(1) of the India-China tax treaty, a resident of China receiving the salary for services rendered in China was taxable only in China. Accordingly, in his India Tax Return (ITR), the assessee had claimed benefit under Article 15(1) of the tax treaty and claimed a refund of Tax Deducted at Source (TDS) by the Indian employer on such salary.

4. The Assessing Officer (AO) had *inter-alia* disallowed the claim of exemption under Article15(1) of the tax treaty on the following basis:

- Article 23 of the tax treaty allows only residents to claim relief under the tax treaty.
- As the assessee qualified as a non-resident in India, he was not eligible to claim relief under Article 15(1) of the tax treaty.

5. On an appeal by the assessee, the Commissioner of Income Tax (Appeals) [CIT(A)] upheld the order of the AO in denying an exemption under Article 15(1) of the tax treaty to the assessee. Aggrieved by the CIT(A)'s order, the assessee went on appeal before the Tribunal relying on the following judicial precedents where claim of exemption under the relevant treaty was allowed for non-residents of India in respect of salary received in India for services rendered outside India by virtue of the respective Articles in the treaties which were worded similar to Article 15(1) of the India-China tax treaty:

- *Bholanath Pal vs. ITO (2012-TII-103-ITAT-Bang.-Intl.)* under Article 15(1) of the treaty between India and Japan.
- *Neeraj Badaya vs. ADIT (2016-TII-19-ITAT-Jaipur-Intl.)* under Article 16(1) of the treaty between India and the USA.
- *ITO vs. Arjun Bhowmik (ITA No. 3484/Del/2012)* under Article 16(1) of the treaty between India and Philippines.

Decision

The Tribunal distinguished the decisions favouring the assessee and held against the assessee as follows:

1. The Tribunal observed that the judicial precedents relied upon by the assessee were not applicable as they were factually different from the case of the assessee as the assessee was a non-resident in India who qualified as a tax resident of China.

2. As the Article 23 of the India-China Tax Treaty applies only to residents of India, the assessee, by virtue of being a non-resident in India, was not eligible to claim exemption under Article 15(1) of the treaty.

3. The Chennai Tribunal upheld the order of the CIT(A) and denied an exemption under Article 15(1) of the tax treaty to the assessee.

(Note: The Reader may also refer to the favourable decision of Karnataka High Court in the case of *DIT vs. Prahlad Vijendra Rao [2011] 198 Taxman 551 (Kar.)*)

14) India-Singapore DTAA – Whether gains arising from the grant of the

call option for 150 years are taxable as capital gains under the tax treaty – Held : No; in favour of the assessee

Shri Praful Chandaria vs. Addit and Purse Holdings India Pvt. Ltd. vs. Addit (International Taxation) 2016-TII-206-ITAT-Mum-Intl. –Assessment year: 2002-03

Facts

1. The assessee is a non-resident Indian (NRI) residing in Singapore and is a tax resident of Singapore. The assessee had acquired certain equity shares in Purse Holding (India) Pvt. Ltd. (PHIL), which was established as a Special Purpose Vehicle (SPV) along with ING Barring Mauritius (BM), a company registered in Mauritius. Both PHIL and BM had invested in an Indian company named as ING Barring India Pvt. Ltd. (BI) having two Indian directors.

2. BI was mainly established as a non-banking finance company dealing in investment banking, brokerage business, etc. in India. The BM held 75 per cent of the shareholding, whereas PHIL held 25 per cent of the shareholding in BI. The assessee's share in PHIL was more than 99 per cent, and it had two other Indian directors who were having one equity share each in PHIL.

3. On 19th November, 2009, the assessee along with other two directors entered into the 'Call Option Agreement' between BM and the first shareholders to sell their shares held in PHIL to BM. The call/strike price was agreed at USD1. As per the said agreement, the entire consideration for the grant of 'call option' was to be paid by BM to the first shareholders in their bank accounts.

4. The right of 'call option' was to be exercised within the period of 150 years and it was agreed that, upon the receipt of call notice and the payment of call value, the first shareholders should be obliged to transfer the shares to BM within one month of the payment of call value.

5. There was another 'Call Option Agreement' (the second agreement) dated 14th December, 2001, between PHIL and BM, whereby PHIL agreed for giving BM an option to purchase the entire shares held by PHIL in BI, and the consideration for this option was agreed at strike value/call price at INR1, and period of option was again for 150 years.

6. In response to the show cause issued by the Assessing Officer (AO), the assessee submitted that he has not transferred any of his shares in PHIL to BM. Therefore, there is no question of earning any capital gain from transfer of shares, and in any case, no income has accrued or arisen to him under section 9(1)(i) of the Act.

7. However, the AO held that the assessee had effectively alienated his shares in PHIL by way of an irrevocable undertaking and the power of attorney (POA) for which consideration was already received. The assessee had received income through or from the transfer of the capital asset situated in India, and therefore, the consideration received by the assessee is taxable in India as per section 5(2) read with section 9(1) of the Act.

Decision

The Tribunal held in favour of the assessee as follows:

A) Re: Giving a call option for perpetuity amounts to transfer of asset

1. In common parlance, a call option is reckoned as a contract in which the holder (buyer) has the right (but not an obligation) to buy a specified quantity of a security/share at a specified price (strike price) within a fixed period. For the writer (seller) of a call option, it represents an obligation to sell the underlying security at the strike price if the option is exercised. The call option writer is paid a premium for taking on the risk associated with the obligation.

2. In the present case, there is an agreement/arrangement, where the strike price has been mentioned as USD 1 and the period for exercising the call option has been fixed for 150

years. This fact itself means that the call option in the shares has been given for perpetuity. Also, an irrevocable POA has been executed in favour of ING Bank in respect of all the shares in PHIL, confirming that the assessee will not at any time purport to revoke the same. These facts, *inter alia* show that the assessee has alienated a substantive and valuable right as an owner of the shares in perpetuity, albeit without *de jure* (legally) alienating the shares itself.

3. Based on the 'call option agreement' and other material facts on record, a valuable and substantive right in the shares of PHIL, namely giving the right to sell shares at a determined price, has been alienated by the assessee and hence it cannot be held merely as a call option agreement simpliciter.

4. In the present case, though, there may not be any actual alienation of shares in terms of the 'call option agreement', but a valuable and substantive right in the shares of an Indian company have been given to a non-resident company i.e. BM.

5. Under normal circumstances, no right in the shares is given away by way of 'call option', albeit only right to buy the shares at a strike price within a stipulated time period is given, which may not be termed as 'capital asset' under section 2(14), because, without exercising the option no actual asset is created.

6. In the present case, the right in the shares has been given for an incredibly large period of 150 years. Also, the rights which are enjoyed by the assessee as a shareholder have been exercised by the POA holders to participate in the affairs of the company, and the assessee shall not at any time purport to revoke the same. Such a bundle of substantive rights is generally not given under normal 'call-option agreements'.

7. In the peculiar facts of the present case, such an option right in the shares has to be reckoned as transfer / alienation of a valuable and substantive right, which would be a class of asset in itself, separate from shares, which though continue to stand in the name of the assessee. Such valuable rights / interest in shares would certainly be a 'capital asset'. Parting with any substantive interest in the asset or creating any substantive interest in any asset or extinguishment of a right / s in an asset, directly or indirectly would surely be reckoned as a 'transfer' of an asset / property even under section 2(47) of the Act.

8. Hence, the consideration received has to be taxed under the head 'Capital gain' as there is a transfer of an asset / property.

B) Taxability of capital gains under the tax treaty

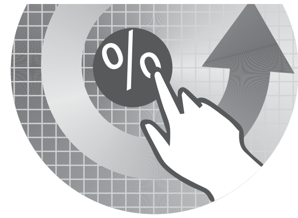
1. Paragraphs 1, 2 and 3 of Article 13 of the tax treaty, would not be applicable in this case. The alienation of shares as mentioned in paras 4 and 5 of Article 13 will not be applicable because no actual shares have been transferred or alienated.

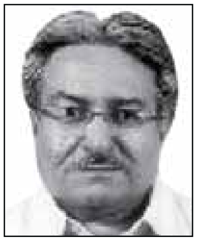
2. A substantive and valuable right has been given in the shares, which has to be reckoned as capital asset or property; hence, it is the gains from the alienation of an asset or property. Any gain from the alienation of such kind of 'property', will fall within the scope of Para 6 of Article 13, whereby the taxing right has been given to the Resident State, i.e. the State of the alienator, namely Singapore. The allocation of taxing right under Article 13(6) cannot be attributed to India, but to the Resident State.

3. Firstly, the consideration received by the assessee is arising from the assignment of substantive and valuable rights in the shares of an Indian company, which is assessable under the head 'Capital gain'. Secondly¸ such a capital gain cannot be held to be taxable in India in terms of para 6 of Article 13 of the tax treaty.

(Note: In this connection, the reader may also refer to the following decisions:

- *Vodafone India Services (P.) Ltd. vs. CIT [2016] 69 taxmann.com 283 (Bom.)*
- *CIT vs. Vodafone India Services (P.) Ltd. [2016] 70 taxmann.com 383 (SC))*





CA Janak Vaghani

INDIRECT TAXES
VAT Update

1. Amendment to The Maharashtra Settlement of Arrears in Disputes Act, 2016 – Mah. Ordinance Nos. XXIII and XXIV of 2016, dated 21 and 29-9-2016, respectively

The Governor of Maharashtra has promulgated above referred two ordinances to amend the Maharashtra Settlement of Arrears in Disputes Act, 2016 to:

a) Remove condition for obtaining stay.

b) Adjust any payment made after passing of any statutory order whether before or after filing of appeal against first tax amount and then to interest and penalty, if any.

c) To extend the time limit for application from 30-9-2016 to 15-11-2016.

2. Notification No. VAT. 1516/ CR 123/ Taxation-1, dated 16th September, 2016 – Increase in rate of VAT

The Government of Maharashtra has issued above notification to increase the rate of VAT on sale of goods from 17-9-2016 as under:

a) Goods specified in Schedule C liable to tax @ of 5.5% is increased to 6%.

b) Goods specified in Schedule E under residual Entry-1 liable to tax @ 12.5% is increased to 13.5%.

c) Petrol covered by Entry 10(a) and (b) of Schedule D-Rate is increased by 2 ` Per liter.

3. Trade Circular

i) Trade Circular No. 25T of 2016, dated 7-7-2016 – Facility to avail online Services through E-Sewa Kendra

The Commissioner of Sales tax by above referred trade circular informed about facility to avail online services including application for registration, online returns etc. through E-Sewa Kendra. Any dealer can approach E Sewa Kendra for availing any online services provided by VAT department, at reasonable price. The list of E-Sewa Kendra can be availed at following link; – “https://www.mahaonline.gov.in/molweb/PublicApp/ utility/viewsewakendra.aspx.”

Further, for e-returns filing, nodal help desks at all locations are made available. The list of such help desks is available at website of the department “https:// www.mahavat.gov.in” in What’s New section.

ii) Trade Circular No. 26T of 2016, dated 8-9-2016 – Grant of Administrative Relief to Developers

The Commissioner of Sales tax by above referred trade circular clarified to grant administrative relief to all developers who had paid compounding fee late i.e. after 30-11-2012 subject to fulfilment of other conditions mentioned in earlier circulars.

iii) Trade Circular No. 27T of 2016, dated 21-9-2016 – Amendments to The Maharashtra Settlement of Arrears in Disputes Act, 2016, Mah. Ordinance No. XXIII of 2016

The Commissioner of Sales tax by above referred trade circular informed about amendments made in The Maharashtra Settlement of Arrears in Disputes Act, 2016 by Mah. Ordinance No. XXIII of 2016, dated 21-9-2016.

iv) Trade Circular No. 28T of 2016, dated 23-9-2016 – Grant of Administrative Relief under MVAT, CST and Luxury tax Acts

The Commissioner of Sales tax by above referred trade circular has amended the Circular No. 13T of 2016, dated 5-5-2016. Accordingly, the application for grant of administrative relief for registration shall be made by dealers who are within jurisdiction of LTU to respective Joint Commissioner of Sales Tax.

v) Trade Circular No. 29T of 2016, dated 23-9-2016 – Special Amnesty for Closed Units Which cannot be revived under The Maharashtra Industrial Policy, 2013

The Commissioner of Sales tax by above referred trade circular to inform about the extension of date, from 31-3-2015 to 31-3-2017, of Special Amnesty for closed units which cannot be revived under the Maharashtra Industrial Policy, 2013.

vi) Trade Circular No. 30T of 2016, dated 1-10-2016 – Extension of due date for submission of application for Refund in Form 501 for the year 2014-15

The Commissioner of Sales tax by above referred trade circular extended the due date for submission of e-application of refund for the year 2014-15 from 30-9-2016 to 8-10-2016.

vii) Trade Circular No. 31T of 2016, dated 1-10-2016 – Extension of due date of Settlement Act and certain Clarifications

The Commissioner of Sales tax by above referred trade circular inform about the extension of time limit for application of settlement from 30-9-2016 to 15-11-2016 by amendment to The Settlement Act, 2016 by Mah. Ordinance No. XXIV of 2016, dated 29-9-2016. Further it is clarified in the said circular that if payment made before passing of any statutory order is not given credit then the nodal officer shall give it and will reduce the demand by consequential interest in the proceeding sheet. Accordingly, the amount payable under amnesty shall be modified.

As regards application for settlement of penalty under section 61(2) it was required to submit audit report on or before 31-10-2016 to avail amnesty. It is clarified in the above circular that in order to avail amnesty it is not required to submit audit report.

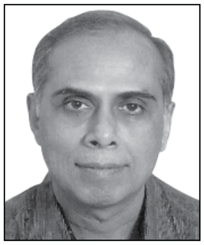
4. Website Updates

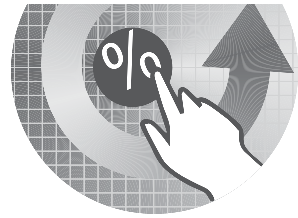
i) Facility to upload Form I under the Settlement of Arrears in Dispute Act, 2016

Facility to up load Form I, an application for settlement of Arrears in Dispute is made available under "e-services>e-Amnesty 2016".

ii) Goods and Services Tax – An Overview

The department has issued "Goods and Services Tax- An Overview on Draft Model GST Law which is made available on website under "What's New" section.





CA Rajkamal Shah & CA Naresh Sheth

INDIRECT TAXES

Service Tax – Statute Update

1. Changes in jurisdictional powers for adjudication

Sr. No	Rank of the Central Excise Officer	Amount of service tax or CENVAT credit specified in a notice issued under the Finance Act, 1994
1	Superintendent	Not exceeding rupees ten lakh (excluding the cases relating to taxability of services or valuation of services and cases involving extended period of limitation)
2	Assistant Commissioner or Deputy Commissioner	Not exceeding rupees fifty lakh (except cases where Superintendents are empowered to adjudicate)
3	Joint Commissioner or Additional Commissioner	Rupees fifty lakh and above but not exceeding rupees two crore
4	Commissioner	Without limit

(Notification No. 44/2016-ST, dated 28-9-2016)

2. Exemption for Yoga conducted by Charitable Institutes

The Central Government has exempted service by way of advancement of Yoga provided by the entities registered u/s. 12AA of IT Act on 1-7-2012. Earlier exemption was provided from 20-10-2015. It has been declared that those entities which have not paid service tax from 1-7-2012 upto 20-10-2015 shall not be required to pay the same now

(Notification No. 42/2016-ST, dated 26-9-2016)

3. Exemption to long term lease of industrial plots by State Government Industrial Development Corporations/Undertakings

Central Government has exempted service by State Government Industrial Development Corporations/undertakings in relation to service by way of granting long term lease of industrial plots for which one time upfront payment, whether called as premium, salami, cost, price, development charges or any other name.

(Notification No. 41/2016-ST, dated. 22-9-2016)

4. Renting of precincts of a religious place meant for general public

Amendment is made in exemption Entry 5(a) of Notification No. 25/2012–ST to the effect that the entity providing service should be owned or managed by a charitable or religious trust registered under section 12AA of the Income-tax Act, 1961 or a trust or an institution registered under sub clause (v) of clause (23C) of section 10 of the Income-tax Act or a body or an authority covered under clause (23BBA) of section 10 of the Income-tax Act.

Services by a person by way of conducting any religious ceremony remains exempt as before.

(Notification No. 40/2016-ST, dated 6-9-2016)

It has been clarified that, the word 'precincts' and all immovable property of the religious place located within the outer boundary walls of the complex (of buildings and facilities) in which the religious place is located, as being located in the precincts of the religious place. The immovable property located in the immediate vicinity and surrounding of the religious place and owned by the religious place or under the same management as the religious place, may be considered as being located in the precincts of the religious place and extended the benefit of exemption under Notification No. 25/2012-Service Tax, SI. No. 5(a) dated 20-6-2012.

(Circular No.200/10/2016-ST, dated 6-9-2016)

5. Exemption to telecom service provider to operate or use radio frequency spectrum

Services provided by Government or a local authority by way of allowing a business entity to operate as a telecom service provider or use radio frequency spectrum shall now be applicable for any period prior to 1-4-2016 instead of only financial year 2015-16.

(Notification No. 39/2016-ST, dated 2-9-2016)

[Above changes are effective from the date of respective notifications unless otherwise specified]

6. Guidelines of arrest in relation to punishable offences

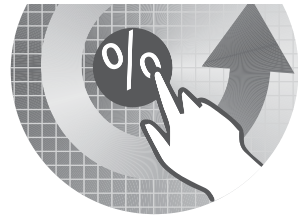
In furtherance to Circular F. No. 137/47/2013-ST detailing procedure for arrest and post-arrest formalities and reporting system, the Government has issued detailed guidelines for carrying out arrests. It has been reiterated that arrest and prosecution should not be resorted in case of technical nature, that is where the additional demand of duty or tax is based totally on difference of opinion regarding interpretation of law.

It has been further clarified that, all cases where sanction of prosecution is examined and accorded after the issue of this circular, shall be dealt in accordance with the provisions of this circular, irrespective of the date of the offence. Cases where prosecution was sanctioned but no complaint has been filed before the magistrate shall also be reviewed by the prosecution sanctioning authority in light of the enhanced monetary limit and sanction withdrawn for cases where evasion of Central Excise Duty or misuse of CENVAT credit is below the revised monetary limit of rupees two crore.

It is emphasised once again that since an arrest impinges on the personal liberty of an individual, this power should be exercised with great responsibility and caution and only after a careful examination of the legal and factual aspects indicated in the preceding paragraphs.

For detailed guidelines, the circular may be accessed from the website of the Chamber.

(Circular No. 201/11/2016-ST dated 30-9-2016)



CA. Bharat Shemlani

INDIRECT TAXES
Service Tax – Case Law Update

1. Services

Accommodation Service

1.1 Federation of Hotels & Restaurants Association of India vs. UOI 2016 (44) STR 3 (Del.)

The High Court in this case held that, services to any person by hotel, inn, guest house, club or camp-site by whatever name called for providing of accommodation for continuous period of less than three months is taxable event that is entirely covered by term "Luxuries" in Entry 62 of List II of Constitution of India and, therefore outside the legislative competence of Parliament. Section 2(i) of Delhi Tax Luxuries Act, 1996 defines identical services of providing accommodation in hotel, with only additional pre-fix in Section 65(105) (zzzzw) of FA, 1994 is hyphenated word "short-term" followed by expression "for period of less than three months". Such provision of short-term accommodation of less than three months is not exempt from luxury tax under Delhi Act. For both the Acts taxable event is same.

Service Tax Valuation Rules, 2006 do not provide machinery for levy and collection of tax on accommodation and rebate on room tariff and in absence of such machinery, levy is invalid. Exemption from service tax on accommodation for room having declared tariff was immaterial as it was provided by Notification No. 12/2012-ST and not in Act or Rules.

It is further held that, Parliament has legislative competence to levy service tax on provision to any person by restaurant having facility of air conditioning in any part of its establishment serving food or beverage, including alcoholic beverages or both. The Legislative carving out of service portion of composite contract of supply of food and drink has sound Constitutional basis and even if this is viewed as Parliament deploying legal fiction, it is legally permissible. Article 366(29A) of the Constitution of India is not just 'supply' but 'supply of goods', which connotes that dominant nature of transaction is transfer, delivery or supply of goods and provision of service is only incidental to such transfer, delivery or supply. By same logic even if some part of composite transaction involves rendering of service, Union Government has power to bring to tax that portion.

It is also held that, Rule 2C is Constitutionally valid as it enables assessing authority to put definite value to service portion of composite contract of supply of goods and services in air conditioned restaurant.

Consulting Engineer Service

1.2 Tata Consultancy Service vs. UOI 2016 (44) STR 33 (Kar.)

The High Court in this case held that, there is clear intent of Legislature to bring consulting engineer within the ambit of service tax and no justification to differentiate between company and individual as nothing in statute which would prevent inclusion of a company. In whatever form service is rendered, it is chargeable for service tax as long as rendered by consulting engineer whether it is by an individual, firm, company or association of persons etc. The assessee company is providing consultancy service as consulting engineer chargeable to service tax as consulting engineer.

Manpower Recruitment and Supply Agency Service

1.3 *Sydenham Institute of Management vs. CCE, Mumbai-I 2016 (44) STR 69 (Tri.-Mumbai)*

The department in this case sought to demand tax on placement fees. The Tribunal observed that, the appellant is Government of Maharashtra aided institute incorporated in the year 1983 and conducts courses in Masters in Management Studies and Post Graduation Diploma in Business Management recognised by University of Mumbai and Government of Maharashtra respectively. It is held that, amount collected is nothing but amount to defray the expenses incurred by institute for organising the campus interview and is not taxable as manpower recruitment and supply agency service.

1.4 *Spirax Marshall P. Ltd. vs. CCE, Pune-I 2016 (44) STR 310 (Tri.-Mumbai)*

The Tribunal in this case relying upon earlier decisions held that, deputing employees to group companies is not taxable under the impugned service.

Business Auxiliary Service

1.5 *Milind Kulkarni vs. CCE, Pune-I 2016 (44) STR 71 (Tri.-Mumbai)*

The appellant is engaged in developing mobile software for overseas customers. The department confirmed demand on the ground that appellant and its branches are different persons and for that purpose activities of the branches are for rendering service to the head office in India and that the payment made to branches are not reimbursements but taxable consideration for taxable service. The Tribunal held that, a branch is an entity distinguishable for purpose of FA, 1994 from it is head office. Section 66A(2) of FA, 1994 is limited to being a charging section in a specific context, it is not elastic enough to govern the corporate intercourse and commercial indivisibility of headquarters and its branches. Thus any service rendered to other contracting party by branch as a branch of service provider would not be within the scope of Section 66A. Merely because there is a branch and that branch has, in some way contributed to activities of appellant in discharging its contractual obligation the definition of BAS does not apply.

It is further held that, mere existence as a branch for overall promotion of the objectives of primary establishment in India which is essentially exporter of service does not render the transfer of financial resources to the branch taxable under Section 66A of FA, 1994.

It is also held that, whether flow of funds from head office to the branch is consideration or reimbursement need not be examined as the test of service having been received in India fails.

1.6 *Anshita Chawla & Ors. vs. CST, New Delhi 2016 (44) STR 300 (Tri.-Del.)*

The Tribunal in this case held that, commission earned on promotion/marketing of products under multi-level marketing scheme is liable to tax under BAS.

Intellectual Property Service

1.7 *Reliance Industries Ltd. vs. CCE&ST, Mumbai 2016 (44) STR 82 (Tri.-Mumbai)*

The Tribunal in this case held that, only those IPR are taxable which are recognised under any law for time being in force in India as is apparent from definition of impugned service. In the present case, except for one IPR, none of other IPRs registered/recognised in India and hence service tax is not leviable on said IPRs under IPR service. Further, the recognised IPR service having been provided prior to introduction of levy i.e., 10-9-2004, service tax not demandable notwithstanding that payment for this service received in piecemeal manner over period of time after levy. It is settled law that where a credit of service tax paid is available to same assessee, intention to evade duty cannot be attributed. In the instant case even if service tax had been paid under RCM, situation would have been revenue neutral on availing credit of tax paid and therefore extended period of limitation is not applicable.

Franchise Service

1.8 Mahyco Monsanto Biotech (India) Pvt. Ltd. vs. UOI 2016 (44) STR 161 (Tri.-Mum.)

The High Court in this case observed that, franchise agreement were limited to precise period of time at the end of which or before if there was any breach of its terms, right of franchisee to display mark of franchisor and its trade dress, and all other permission ended. It is held that it is not a sale and it is classic example of permissive use of defined intangible rights, which is subject only to service tax and not to VAT. There are set terms provided by agreement which have to be followed, breach of whereof terminates agreement and there was no passage of any kind of control or exclusivity to franchisee.

It is also held that, situs for franchisee agreements is place where such agreements were executed i.e. Delhi in this case.

In other appellants case it is observed that, sample seeds impregnated with proprietary technology supplied/sub-licenced to third parties who generated large quantities of sowable seeds from it, and commercialise technology to produce hybrid seeds for sale to cotton growers. The plea that this transaction was one of merely service/permissive use and that seeds were merely media is rejected as technology could not have been given to sub-licensee without seeds, and there was no other method demonstrated anywhere of effecting any such transfer. It is held that, seeds embedded with technology were transferred and it was case of transfer of right to use goods and therefore liable to VAT.

Construction Service

1.9 Bharat Bhushan Gupta & Co. vs. State of Haryana 2016 (44) STR 195 (P&H)

The appellant in this case constructed houses for State Housing Board for Below Poverty Line persons. The High Court held that, Board was Governmental authority as it was set up under State Act and it was totally controlled by State Government. BPL houses constructed by contractor were meant for residential purpose and not for commerce, industry or any other business or profession. Hence, services provided by contractors was within exemption clause 12 of Notification No. 25/2012-ST dated 20-6-2012 and from that date Board cannot deduct service tax from bill of the contractor.

1.10 Ultratech Concrete vs. CST, Delhi 2016 (44) STR 274 (Tri.-Del.)

The Tribunal in this case held that, pumping of RMC at desired spot is not a part of service but a sale of RMC as held in case of *GMK Concrete Mixing Pvt. Ltd. 2012 (25) STR 357 (Tri.)* and therefore not liable to service tax.

1.11 E. M. Mani Constructions Pvt. Ltd. vs. CCE&ST, Cochin 2016 (44) STR 265 (Tri.-Bang.)

The Tribunal after relying on Larger Bench decision in *Bhayana Builders Pvt. Ltd. 2013 (32) STR 49 (Tri-LB)* held that value of free supplies made by service recipient is not includible in assessable value of services.

Site Formation Service

1.12 Sushee Infra Pvt. Ltd. vs. CCEC&ST, Hyderabad-II 2016 (44) STR 263 (Tri.-Bang.)

The Tribunal in this case relying on decision of S. V. Engineering Construction dated 30-12-2013 held that value of diesel and explosives supplied are not includible in gross value of Site Formation Service.

Club or Association Service

1.13 CST-I, Mumbai vs. Apsara Co-op. Housing Society Ltd. 2016 (44) STR 303 (Tri.-Mumbai)

The Tribunal in this case held that, collection of subscription to manage, maintain and administer buildings is not liable to service tax as the issue is covered under catena of decisions.

Also refer to decision in *Indian Banks Association vs. CST, Mumbai-I 2016 (44) STR 304 (Tri-Mumbai)*

2. Interest/Penalties/Others

2.1 Kolland Developers Pvt. Ltd. vs. CCE, Nagpur 2016 (44) STR 65 (Tri.-Mumbai)

The Tribunal in this case held that, SEZ developer claiming exemption by way of refund under Notification No. 12/2013-ST has to fulfil conditions of notification at the time of availing exemption and not thereafter as the said notification is beneficial notification. The appellant having not fulfilled mandatory condition of getting services approved by Approval Committee at the time of availing exemption, not entitled to refund of service tax paid.

2.2 Global Networking Recourses vs. Principal Commr., ST Pune 2016 (44) STR 94 (Tri.-Mumbai)

In this case appellant failed to deposit 50% of tax declared by due date under STVCES, 2013. The Tribunal held that, there is no provision in Scheme to condone delay in payment even if reason for such delay found acceptable. Time line prescribed under Scheme cannot be extended.

2.3 Bajaj Auto Ltd. vs. CCE&ST, LTU Mumbai 2016 (44) STR 108 (Tri.-Mumbai)

The appellant in this case sought interest on delayed refund of pre-deposit @ 12% as allowed by *Apex Court in ITC Ltd. 2005 (179) ELT 15(SC)*. The Tribunal held that, the said judgment allowing higher rate of interest in terms of inherent powers held by Apex Court and Tribunal being a creature of statute, cannot decide cases beyond specific provision of CEA, 1944. Since interest is allowed to appellant @ 8%/6% is as per statutory provisions, interest @ 12% is not admissible.

2.4 Adani Power Ltd. vs. CST, Ahmedabad 2016 (44) STR 146 (Tri.-Ahmd.)

In the present case, department restricted refund of service tax under para 2(d) of impugned notification proportionate to use in electricity consumed within SEZ and denying refund for surplus electricity supplied in DTA in terms of Rule 47(3) of SEZ, Rules. The Tribunal held that, assessee an SEZ under power sector, generating electricity as its authorised operation and supply of such electricity to other SEZs, EOUs and others duly approved by Approval Committee. Further, they have been granted specific permission by competent authority to supply surplus electricity under impugned Rules in DTA on payment of duty on raw materials and consumables. Mere selling of surplus power in DTA by installing dedicated transmission lines, not meaning that assessee owns or carried on any business other than SEZ operation. Thus assessee clearly fulfilling condition of paras 2(b) and 2(c) of Notification No. 17/2011-ST and therefore entitled to refund.

2.5 Sudhir Kumar Tripathi vs. CCE&ST, Jamshedpur 2016 (44) STR 251 (Jhar.)

The petitioner in this case challenged summons issued to him with request to allow presence of his lawyer during investigations. The High Court held that, presence of lawyer in response to summons has no meaning as questions which are to be asked from persons summoned cannot be asked from lawyer. Investigations, which is like a game of chess, does not depend on person summoned but on officer who carried out investigation. The Writ Petition dismissed with a cost.

2.6 Plastichemix Industries vs. CCE&ST, Vadodara 2016 (44) STR 254 (Tri.-Ahmd.)

In this case the service tax on GTA wrongly paid in other sister unit's account. The appellant sought to adjust the same. The Tribunal held that, there being no statutory provision, such adjustment is not permissible and demand and interest on one unit confirmed. However, second unit is entitled to take credit of amount wrongly paid.

3. CENVAT Credit

3.1 Monarch Catalyst Pvt. Ltd. vs. CCE, Thane-I 2016 (44) STR 96 (Tri.-Mumbai)

The Tribunal allowed CENVAT credit of service tax paid on event organised to show new plant and its production capacity to prospective buyers as the same is part of sales promotion activity.

3.2 L. G. Electronics India Pvt. Ltd. vs. CCE&ST, Noida 2016 (44) STR 97 (Tri.-All.)

In the present case Tribunal allowed CENVAT credit of service tax paid on shifting expenses on transfer of employees as the same has been incurred to comply with transfer policy of staff amongst its various units in pursuance of its business activities.

3.3 CCE, Nagpur vs. International Combustion (I) Ltd. 2016 (44) STR 110 (Tri.-Mumbai)

The Tribunal in this case allowed CENVAT credit on various activities like cleaning, garden maintenance, civil and construction work, painting and fencing work, having been rendered in factory premises are in relation to manufacturing activity only.

3.4 Rashtriya Ispat Nigam Ltd. vs. CCEC&ST, Visakhapatnam 2016 (44) STR 136 (Tri-Hyd.)

The appellant in this case availed CENVAT credit of service tax paid on erection/ construction of underground and overground pipelines for supply of water to raw materials plant as work of construction of pipeline or conduit. The Tribunal held that, it does not fall in exclusion portion of definition of input service under Rule 2(l) of CCR, 2004 and the appellant is eligible for credit of service tax paid. The definition of construction service under Section 65(25b) of FA, 1994 gives two services under two different sub-clauses which means that construction of pipeline or conduit cannot be considered to be part of construction of building or civil structure. Similarly these services are distinct under definition of works contract services, which indicates that wherever Legislature wanted to include construction of pipeline or conduit, it has specifically mentioned separately in definition. This also shows that erection/construction of pipeline or conduit cannot be considered as part of construction of building or civil structure or part thereof.

3.5 CCE&ST, Bengaluru-IV vs. Ultra Tech Cement Ltd. 2016 (44) STR 227 (Kar.)

The High Court observed that the factual findings of Tribunal indicated that goods delivered on FOR destination base with risk and ownership remaining with assessee till goods reach customer. Since the said findings having become final, all conditions of CBEC Circular No. 97/8/2007-STdated 23-8-2007 fulfilled and credit not deniable.

3.6 Newlight Hotels & Resorts Ltd. vs. CCE&ST, Vadodara 2016 (44) STR 258 (Tri.-Ahmd.)

The department in this case sought to change the classification of service at recipient end. The Tribunal held that, change of classification of service at service recipient end not permissible as service provider paying service tax at behest of Department and such payment not disputed or denied.



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 & Notifications issued by RBI and also FAQs issued by RBI:

A. Circulars & Notifications issued by RBI

1. Investment by Foreign Portfolio Investors (FPI) in Government Securities

Investment by Foreign Portfolio Investors (FPI) in Government securities is permissible under Schedule 5 to Notification No. 20 - Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000. The limits for investment in Government securities was last increased in terms of the Medium Term Framework (MTF) announced vide A.P. (DIR Series) Circular No. 55 dated March 29, 2016.

As announced in the MTF, the limits for investment by FPIs in Central Government Securities for the next half year are proposed to be increased in two tranches, each of ` 100 billion from October 3, 2016 and January 2, 2017 respectively.

Similarly, the limits for State Development Loans (SDLs) are proposed to be increased in two tranches, each of ` 35 billion, from October 3, 2016 and January 2, 2017 respectively.

The total increase in limits over the next two quarters would, accordingly, be as under:

(in INR Billion)

	Central Government Securities			State Development Loans	Aggregate
	For All FPIs	Additional for Long Term FPIs	Total	For all FPIs (including Long Term FPIs)	
Existing Limits	1,440	560	2,000	140	2,140
Revised limits with effect from October 3, 2016	1,480	620	2,100	175	2,275
Revised limits with effect from January 2, 2017	1,520	680	2,200	210	2,410

It is also specified that for the transfer of unutilised portion of "Long Term FPI" category to "All FPIs" category, a separate communication will follow.

(A.P. (DIR Series) Circular No. 4 dated 30th September, 2016)

(Comments: As per news reports, this relaxation has already resulted in inflow of USD 2 billion in such securities)

2. Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Thirteenth Amendment) Regulations, 2016

RBI has notified changes in Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000, (Notification No. FEMA 20/2000-RB dated 3rd May 2000), in Schedule 1, in Annex B, Paragraph F.8, which shall be effective from the date of Notification in Official Gazette

Paragraph F.8 shall be substituted by the following, namely:

F.8	**Other Financial Services**		
	Financial Services activities regulated by financial sector regulators, viz., RBI, SEBI, IRDA, PFRDA, NHB or any other financial sector regulator as may be notified by the Government of India	100%	Automatic
F.8.1	**Other Conditions**		
	i. Foreign investment in 'Other Financial Services' activities shall be subject to conditionalities, including minimum capitalisation norms, as specified by the concerned Regulator/Government Agency. ii. 'Other Financial Services' activities need to be regulated by one of the Financial Sector Regulators. In all such financial services activities which are not regulated by any Financial Sector Regulator or where only part of the financial services activity is regulated or where there is doubt regarding the regulatory oversight, foreign investment up to 100% will be allowed under Government approval route subject to conditions including minimum capitalisation requirement, as may be decided by the Government. iii. Any activity which is specifically regulated by an Act, the **foreign investment limits** will be restricted to those levels/limit that may be specified in that Act, if so mentioned. iv. Downstream investments by any of these entities engaged in "Other Financial Services" will be subject to the extant sectoral regulations and **provisions of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000, as amended from time to time."**		

(Notification No. FEMA 375/2016 – RB dated 9th September, 2016)

(Comments: Under erstwhile FDI Policy, the sector was known as NBFC Sector and permitted investments only under 18 specified activities under the sector. Now this move permits FDI in any other regulated financial services activities as may be notified by the Government and minimum

capitalisation will also be as specified by the concerned Regulator/Government Agency. The ***amendment also allows investment in other*** *financial services activities which are not regulated subject to prior Government approval. Downstream investment is also permitted subject to prescribed guidelines.)*

3. Corrigendum to Notification 5(R) – Foreign Exchange Management (Deposit) Regulations, 2016

RBI has issued corrigendum making following amendments in FEMA Notification No. 5(R)/2016-RB, dated April 1, 2016 bearing G.S.R. 389(E)

– In SCHEDULE 1, under paragraph 6, the sub-paragraph (3) shall be substituted by the following -

"Loans outside India - Authorised dealers may allow their branches/correspondents outside India to grant loans to or in favour of non-resident depositor or to third parties at the request of depositor for bona fide purpose against the security of funds held in the NRE accounts in India and also agree for remittance of the funds from India, if necessary, for liquidation of the outstanding."

(Comments: This is a welcome move through which RBI has withdrawn restrictions on use of borrowed funds for re-lending or carrying on agriculture/plantation activities or for investment in real estate business)

B. FAQs issued by RBI

RBI has issued fresh FAQs on its website https://www.rbi.org.in/scripts/FS_FAQs.aspx?Id=33&fn=5 in an attempt to put in place the common queries that users have on the subject in easy to understand language. However, it is advised that for conducting a transaction, the Foreign Exchange Management Act, 1999 (FEMA) and the regulations made or directions issued thereunder should be referred to. The relevant principal regulations for which FAQs are published are as follows-

– RBI provided the details of Exchange Rate value of INR against USD dollar from the year 1947 till date

– The Foreign Exchange Management (Acquisition and transfer of immovable property outside India) Regulations, 2015 issued *vide* Notification No. FEMA 7(R)/2015-RB dated January 21, 2016 & Notification No. FEMA 21/2000-RB dated May 3, 2000. The directions issued are consolidated in Part I of the Master Direction No 12 on Acquisition and Transfer of Immovable Property under Foreign Exchange Management Act, 1999. Amendments, if any, to the principal regulations are appended.

– The Foreign Exchange Management (Remittance of Assets) Regulations, 2016 issued *vide* Notification No. FEMA 13 (R)/2016-RB dated April 1, 2016. The directions issued are consolidated in the Master Direction No 13 on Remittance of Assets.

Thinking should become your capital asset, no matter whatever ups and downs you come across in your life."

— A. P. J. Abdul Kalam

Ajay Singh, *Advocate* & CA Namrata Bhandarkar

BEST OF THE REST

1. Delay in filing civil suit – Condonation – Sufficient cause – Delay caused due to lack of sound legal advise – Petitioner approached wrong forum – Delay liable to be condoned. Limitation Act Section 5

The truck owned by the respondent herein suffered damage in an accident which occurred on 14-3-2009. The Owner respondent was holding *qua* the ill-fated truck an insurance cover issued by the petitioner, instituted a complaint before the District Consumer Disputes Redressal Forum. On 21-6-2013, the District Consumer Disputes Redressal dismissed the complaint instituted on the ground that the owner respondent is not falling within the definition of "Consumer" rendering the appeal not maintainable. The respondent being aggrieved appealed before the H.P. State Consumer Disputes Redressal Commission, Shimla. The State Consumer Disputes Redressal Commission took a similar view but in the operative part reserved liberty to the respondent to avail any other remedy prescribed under law. Thereafter the respondent filed an appeal before the Trial Court. The Trial Court allowed the claim of the respondent and condoned the delay holding the same to be a *bona fide* delay due to setting in motion an inappropriate remedy before the inappropriate authority. The appellant filed an appeal before the High Court.

The Hon'ble Himachal Pradesh High Court observed that the owner respondent herein under a *bona fide* impression had mis-availed the remedy by putting in motion the legal mechanism ordained in the Consumer Protection Act, besides when its availment appears to stand spurred under a *bona fide* legal advice purveyed to her by her counsel hence the time spent by the respondent herein by bonafidely prosecuting an erroneous remedy or an inappropriate remedy by availing the legal mechanism contemplated in the Consumer Protection Act stood enjoined to be excluded from the period of limitation prescribed under the apposite Article of the apposite statute for ventilating her grievance in Civil Suit filed before the Civil Judge (Junior Division), Bilaspur. Further, the damage suffered by the ill-fated truck in accident did not cease within three years thereafter rather remained alive up to the time when a copy of the H. P. State Consumer Dispute Redressal Commission order was received 1-10-2013. Since, the aforesaid period would stand excluded while computing the period of limitation. Nonetheless the respondent was asked to explain the delay from 1-10-2013 till the date of her instituting a civil suit before the learned Trial Court which stood instituted on 14-11-2013. The aforesaid delay was minimal. The said delay standing begotten by the respondent standing engaged in eliciting sound legal advise *qua* the appropriate legal remedy available to her. It appears that the engagement of the respondent here in eliciting a sound legal advice from appropriate quarters qua the legitimate remedy available to her for securing her claim against the petitioner herein precluded her from 1-10-2013 to 14-11-2013 to institute the civil suit before the learned Trial Court. Consequently, the High Court held that the respondent had projected a good sound and just reason in explaining the delay which occurred from 1-10-2013 up till 14-11-2013 in the institution of the suit by her before the learned Trial Court. The impugned order of the Trial Court was affirmed and application of the appellant stood disposed.

New India Assurance Company Ltd. vs. Smt. Meera Verma AIR 2016 Himachal Pradesh 135

2. Loan Agreement – post-dated cheques given as security towards installment of loan – complaint filed cheques getting dishonoured – Appellant contended that the post dated cheques were given by way of security and no debt or liability was due – Held once issuance and signature are admitted, legally enforceable debt in favour of the holder of the cheque arises and dishonour of cheque being discharge of existing liability is covered by Section 138 – Negotiable Instruments Act, 1881 Section 138

The appellant is director of the company whose cheques have been dishonoured and who is also the co-accused. The company is engaged in the field of power generation. The respondent is engaged in development of renewable energy and is a Government of India enterprise. *Vide* the loan agreement dated 15th March, 2001, the respondent agreed to advance loan of ` 11.50 crores for setting up of 4.00 MW biomass based Power Project in the State of Andhra Pradesh. The agreement recorded that post-dated cheques towards payment of installment of loan (principal and interest) were given by way of security. The cheques carried different dates depending on the dates when the installments were due and upon dishonour thereof, complaints including the one dated 27th September, 2002 were filed by the respondent in the Court of the concerned Magistrate The appellant approached the High Court to seek quashing of the complaints arising out of 18 cheques of the value of about ` 10.3 crores. Contention of the appellant in support of his case was that the cheques were given by way of security as mentioned in the agreement and that on the date the cheques were issued, no debt or liability was due. Thus, dishonour of post-dated cheques given by way of security did not fall under Section 138 of the Act. Reliance was also placed on a clause of the agreement which was worded that the deposit of post-dated cheques were towards repayment of installment by way of "security". The High Court did not accept the above contention and held that in the present case when the post-dated cheques were issued, the loan had been sanctioned and hence the same fell in the first category that is they were cheques issued for a debt in present but payable in future.

Question before the Apex Court was whether the dishonour of a post-dated cheque given for repayment of loan installment which is also described as "security" in the loan agreement is covered by Section 138 of the Negotiable Instruments Act, 1881.

The Hon'ble Supreme Court observed that to determine applicability of Section 138 of the Act is whether the cheque represents discharge of existing enforceable debt or liability or whether it represents advance payment without there being subsisting debt or liability. The question whether a post-dated cheque is for "discharge of debt or liability" depends on the nature of the transaction. If on the date of the cheque liability or debt exists or the amount has become legally recoverable, the Section is attracted and not otherwise. Reference to the facts of the present case clearly show that though the word "security" is used in clause 3.1(iii) of the agreement, the said expression refers to the cheques being towards repayment of installments. The repayment becomes due under the agreement, the moment the loan is advanced and the installment falls due. It is undisputed that the loan was duly disbursed on 28th February, 2002 which was prior to the date of the cheques. Once the loan was disbursed and installments have fallen due on the date of the cheque as per the agreement, dishonour of such cheques would fall under Section 138 of the Act. The cheques undoubtedly represent the outstanding liability. Admittedly, on the date of the cheque there was a debt/liability in presenti in terms of the loan agreement.

The Supreme Court relied further on an earlier decision of the Apex court in *Rangappa versus Shri Mohan (2010) 11 SCC 441,* wherein it was held that once issuance of a cheque and signature thereon are admitted, presumption of a legally enforceable debt in favour of the holder of the cheque arises. It is for the accused to rebut the said presumption, though accused need not adduce his own evidence and can rely upon the material submitted by the complainant. However, mere statement of the accused may not be sufficient to rebut the said presumption. A post dated cheque is a well recognised mode of payment. The Hon'ble Supreme Court therefore accordingly held that the dishonour of cheque in the present case being for discharge of existing liability is covered by Section 138 of the Act and affirmed the order of the High Court.

Sampelly Satyanarayana Rao vs. Indian Renewable Energy Development Agency Limited [Criminal Appeal No. 867 of 2016 (SC) dt. 19-9-2016]

3. Arbitrability of issue – Disputes between beneficiaries arising out of Trust Deed – Arbitration clause present – Beneficiaries not being signatories to Trust Deed – Whether disputes arbitrable

One Shri Dwarkadas Laxmichand Modi executed a family Trust Deed called "Deed of Kaydee Family Trust" on 6-4-1983 as author of the Trust hereinafter called as "settlor" in relation to his properties. The settler formed this Trust out of love and affection in favour of six minors. To manage the affairs of the Trust and its properties, the settlor appointed two persons – Shri Dinesh Nandlal Shah and Smt. Saryu Kishor Shah as Managing Trustees. Clause 20 of the Trust Deed provided that every dispute or differences regarding the interpretation of any of the clauses or provisions or the contents of the Trust Deed or any dispute *inter se* trustees or disputes between the trustees and beneficiaries or disputes between beneficiaries *inter se*, as and when would arise, would be resolved in pursuance of the provisions of the Indian Arbitration Act, 1940 and the decision of arbitrator(s) shall be final and binding on the parties.

Soon, differences cropped up *inter se* beneficiaries with respect to the manner in which the affairs and the business of the Trust were being carried on. Since the parties could not settle the disputes and nor could they agree for the appointment of the arbitrator amicably, respondent Nos. 1 to 3 (one set of beneficiaries) filed an application under Section 11 of the Act in the Bombay High Court against the appellants (other set of beneficiaries) praying for referring all disputes to the arbitrator in terms of clause 20 of the Trust Deed. The application was allowed by the High Court and appointed an arbitrator. Against this order, the appellants filed the present appeal before the Supreme Court.

Held by the Supreme Court, in order to constitute a valid, binding and enforceable arbitration agreement, the requirements contained in Section 7 of the 1996 Act have to be satisfied strictly. In case of a trust, the testator/settlor who signs the document alone. That apart, both the deeds convey the interest in the estate in favour of the legatees or/and beneficiaries. However, since legatee/beneficiaries do not sign the document or we may say are not required to sign such document, they are not regarded as party to such deed despite legatee/beneficiaries/trustees accepting the deed. Such a deed did not partake the nature of an agreement between such parties. Therefore, the trust deed could also not be held to constitute an agreement much less an arbitration agreement despite containing an arbitration clause therein. The disputes had to be decided by the Civil Court as specified under the Indian Trust Act, 1882.

Shri Vimal Kishor Shah & Ors vs. Mr. Jayesh Dinesh Shah & Ors. 2016 (8) SCALE 116

4. Applicability to arbitration petitions filed already filed u/s. 34 of Arbitration and Conciliation Act, 1996 of amendments made by 2015 Act – Whether amendment applicable to awards passed before Amending Act came into force

The award-debtor in the concerned execution applications was the BCCI. It filed applications under Section 34 of the Arbitration and Conciliation Act, 1996 to challenge the arbitral awards. Under the erstwhile law of 1996, pending the challenge under Section 34, an award could not be enforced. An automatic suspension operated on the execution of the award; the award could be otherwise enforced only upon the expiry of limitation period of a S. 34 petition, or upon the dismissal of such application.

After the amendment to the 1996 Act, the law provided that challenge u/s. 34 shall not by itself render the award unenforceable, unless the Court grants an order of stay of operation of said arbitral award. The Respondents contended that the amended Section 36 must be held applicable to the pending court proceedings; after expiry of three months from the date of the arbitral award, the awards become enforceable against the Applicants irrespective of whether a challenge has been filed by them or not.

If the Amended Act was held applicable, after expiry of three months from the date of the arbitral award, it became enforceable in accordance with provisions of the Civil Procedure Code, irrespective of whether a challenge had been filed under section 34 of the Act or not. On the other hand if the Amendment Act was held not applicable, the award-debtor would continue to enjoy the protection against execution during the pendency of the application under section 34.

Held, Section 26 (Saving Clause) of the Amending Act consisted of two parts. The first part provided that nothing contained in the Amendment Act shall apply "to the arbitral proceedings commenced in accordance with Section 21 of the Principal Act" before the commencement of the Amendment Act i.e. prior to 23rd October, 2015, unless the parties agree otherwise. The second part provided that the Amendment Act shall apply "in relation to arbitral proceedings commenced on or after the date of commencement of the Amendment Act" i.e. 23rd October, 2015. The term "arbitral proceedings" had a specific meaning and duration under the Arbitration Act. The term "arbitral proceedings" was held to not include post-award proceedings i.e. proceedings for enforcement of the arbitral award or proceedings to challenge the arbitral award, which arise only after the award was made.

The application of amended Section 36 to the existing matters i.e. the applications under Section 34 those were pending as on 23rd October, 2015 did not amount to giving retrospective effect and it made no difference if the application under Section 34 filed by the award-debtor was prior to 23rd October, 2015. The Amending Act was curative and procedural in nature and after 23rd October, 2015, the award-debtor must, for seeking stay of the arbitral award, make an application in that regard even if the award was passed before 23rd October, 2015.

Rendezvous Sports World vs. Board of Control for Cricket in India, [Chamber Summons No. 1530 of 2015 IN Execution Application (L) No. 2481 of 2015 IN Arbitral Award dt. 22nd June, 2015 – Bombay High Court dated 14th June, 2016]

5. Interpretation – Discretion on court to reduce punishment by way of imprisonment – Whether this implied a discretion to reduce the quantum of fine as well in absence of wording. Section 85 of Employees' State Insurance Corporation Act

Both the Respondents faced trial before the Special Court for Economic Offences, Bengaluru and were found guilty and were inflicted with imprisonment till rising of the Court and fine of ` 1,000/- for failure to pay contributions, u/s. 85 of the Employees' State Insurance Corporation Act. Section 85 reads as follows:

"85. Punishment for failure to pay contributions, etc. – If any person –

(a) Fails to pay any contribution which under this Act he is liable to pay, or

(b) ...

(c) ...

(d) ...

(e) ...

(f) ...

(g) ...

he shall be punishable

(i) Where he commits an offence under Clause (a), with imprisonment for a term which may extend to three years but –

(a) Which shall not be less than one year, in case of failure to pay the employee's contribution which has been deducted by him from the employee's wages and shall also be liable to fine of ten thousand rupees;

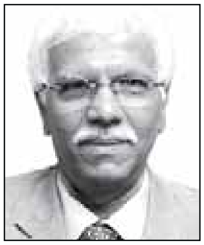
(b) Which shall not be less than six months, in any other case and shall also be liable to fine of five thousand rupees:

Provided that the court may, for any adequate and special reason to be recorded in the judgment, impose a sentence of imprisonment for a lesser term."

According to Appellant, the fine amount could not have been reduced and ought to have been ` 5,000/- as per mandate of law. The proviso empowered the court that it may, "for any adequate and special reasons to be recorded in the judgment, impose a sentence of imprisonment for a lesser term". The question to be answered was whether the court had been given judicial discretion only to reduce the sentence of imprisonment for any term lesser than six months or whether it also had discretion to levy no fine or a fine of less than five thousand rupees.

Held, the object of creating offence and penalty under the Act was clearly to create deterrence against violation of provisions of the Act which were beneficial for the employees. Non-payment of contributions was an economic offence and therefore the Legislature had not only fixed a minimum term of imprisonment but also a fixed amount of fine of five thousand rupees u/s. 85(a)(i)(b). There was no discretion of awarding less than the specified fee, under the main provision. It is only the proviso which was in the nature of an exception whereunder the court was vested with discretion limited to imposition of imprisonment for a lesser term. Further held, there were no words in the proviso for imposing a lesser fine than that of five thousand rupees. In such a situation the intention of the Legislature was clear and when the wordings of the statute were clear, no interpretation was required unless there is a requirement of saving the provisions from vice of unconstitutionality or absurdity. Held, respondents were liable to pay fine of five thousand rupees.

Employees' State Insurance Corporation vs. A. K. Abdul Samad & Anr. (2016) 4 SCC 785



Kishor Vanjara, *Tax Consultant*

TAX ARTICLES FOR YOUR REFERENCE

Articles published in Taxman, Current Tax Report (CTR), The Tax Referencer (TTR), Income Tax Report (ITR), ITR's Tribunal Tax Reports (ITR Tribunal), Sales Tax Review (S. T. Review), The Bombay Chartered Accountant Journal (BCAJ), The Chamber's Journal (CJ), The Chartered Accountant (CAJ), All India Federation of Tax Practitioners Journal (AIFTPJ), Company Case, Times of India (TOI) and Economic Times (ET) for the period August 2016 to September 2016 has been arranged and indexed topic-wise.

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CA Hinesh R. Doshi, CA Haresh P. Kenia
Hon. Jt. Secretaries

The Chamber News

Important events and happenings that took place between 8th September, 2016 and 8th October, 2016 are being reported as under.

I. PAST PROGRAMMES

1. 90TH CELEBRATION COMMITTEE

The inaugural meeting of "90th Year Celebration" was held on 7th October, 2016 at IMC. The meeting was inaugurated by lighting lamp by Guest Speakers, Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court and Shri Dinesh Vyas, Senior Advocate, Supreme Court followed by addressing the members.

The Chamber's Journal in electronic E-pub was launched by Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court. .

2. JOURNAL COMMITTEE

Read CTC - The Chamber's Journal on your Mobile/Tab.

We are glad to announce launch of monthly CTC Journal in electronic E Pub, at the hands of Hon'ble Shri Justice R. V. Easwar, Former Judge of Delhi High Court, on 7th October,2016 at IMC Chamber of Commerce and Industry. Now readers can download the same from the website of the chamber and can read on their IPAD, Mobile or any electronic gadgets format at their convenience

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- Customizable : Change background color, font size, alignment
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3. INDIRECT TAXES COMMITTEE

The Orientation Course on GST Model Law was held on 16th, 21st, 22nd & 23rd September, 2016 at Jai Hind College.

4. LAW & REPRESENTATION COMMITTEE

REPRESENTATIONS BEFORE:

A) **Hon'ble R. V. Easwar, Chairman, R. V. Easwar Committee –** Suggestions on simplification of India Tax Laws

B) **The Hon'ble Commissioner of VAT**

1. Representation for Extension of Time Period of the Settlement of Disputes Scheme
2. Representation for Extension of Time Period of Filing of Form 501

C) **Ms. Rani Singh Nair, Hon'ble Chairperson, CBDT**

1. Extension of due date for filing return of income under Clause (a) of the Explanation to section 139(1) of the Income-tax Act, 1961 ("the Act") – In respect to assessees who are required to carry audit under other law.
2. Certain issues – Income Disclosure Scheme – Requested to clarify.
3. Difficulties for Issue of TDS certificates u/s. 197, TDS certificate generation, etc.
4. Direct Tax Dispute Resolution Scheme, 2016 jointly with BCAS.

5. DELHI CHAPTER

The Full Day Seminar on "M&A and Corporate Restructuring – Legal, Tax & Practical Aspects" was held on 17th September, 2016 at India International Centre, New Delhi.

(For details and Study Material of the Past Programmes, kindly visit www.ctconline.org)

II. FUTURE PROGRAMMES

(For details of the future programmes, kindly visit www.ctconline.org or refer The CTC News of October, 2016)

1. ALLIED LAWS COMMITTEE

The Certificate Training Course in IND – AS (40 Hrs.) (with Knowledge Assessment) jointly with Corporate Members Committee will be held on 12th, 19th, 26th November, 2016 & 3rd, 10th, 17th December, 2016 at Babubhai Chinai Hall, IMC.

2. CORPORATE MEMBERS COMMITTEE

1. The listed corporate SAGA Insider Trading – An Insight will be held on 11th November, 2016 at Babubhai Chinai Hall, IMC.
2. The Full Day Seminar on Alternative Fund Raising options for Corporates jointly with Bombay Chartered Accountants' Society will be held on 25th November, 2016 at Walchand Hirachand Hall, IMC.

3. DIRECT TAXES COMMITTEE

The Full Day Seminar on Surveys under Income-tax & TDS Surveys will be held on 19th November, 2016 at M. C. Ghia Hall.

4. INDIRECT TAXES COMMITTEE

A) The Orientation Course on GST Model Law will be held on 15th, 16th, 17th & 18th November, 2016 at Jai Hind College.

B) The 5th Residential Refresher Course on Service Tax will be held from 26th to 28th January, 2017 at Bogmallo Beach Resort, Goa.

5. INTERNATIONAL TAXATION COMMITTEE

A. The Basic Intensive Study Course on FEMA will be held on 14th, 15th, 21st and 22nd October, 2016 at M. C. Ghia Hall.

B. The Workshop on Taxation of Foreign Remittances will be held on 25th & 26th November, 2016 and 9th & 10th December, 2016 at M. C. Ghia Hall.

C. The publication on Transfer Pricing Industry & Technical Perspective (Reprint July 2014 Edition) on Special Price for members only ` 950/- [Book MRP – ` 1995].

6. MEMBERSHIP & PUBLIC RELATIONS COMMITTEE

The Half Day Seminar on Survey, Search & Seizure jointly with Vapi Branch of WIRC of ICAI will be held on 22nd October, 2016 at Vapi Branch of WIRC of ICAI, Vapi.

7. RESIDENTIAL REFRESHER COURSE & SKILL DEVELOPMENT COMMITTEE

A) The 40th Residential Refresher Course will be held between 16th and 19th February, 2017 at The Golden Palms Hotel and SPA Resort, Bengaluru.

8. DELHI CHAPTER

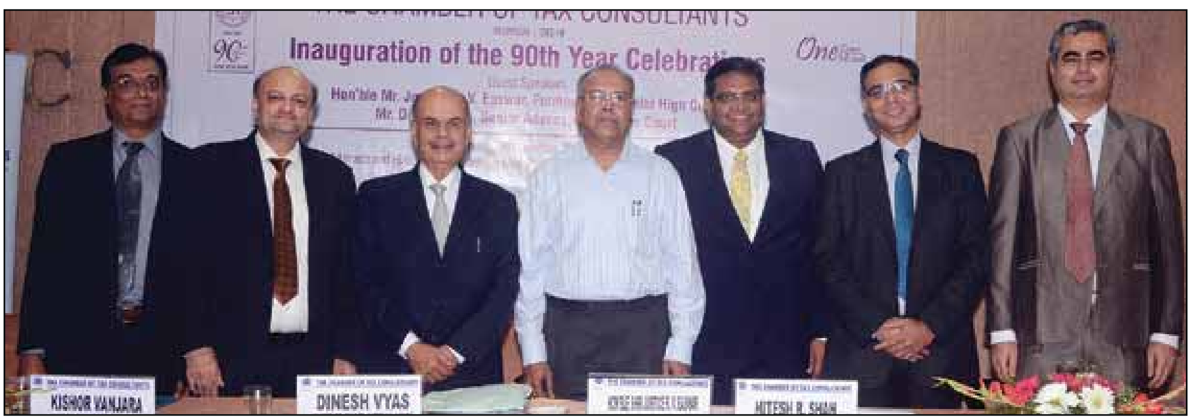
The Seminar on "Inbound Investments & Exit Strategy – Structuring, Funding, Business Models, Legal, Regulatory & Taxation Aspects" will be held on 22nd October, 2016 at India International Centre, New Delhi.

90TH YEAR CELEBRATION COMMITTEE

Inauguration function of "90th Year Celebration" held on 7th October, 2016 at IMC

Master of Ceremonies
CA A. S. Merchant, Past President and
Ms. Varsha Galvankar, Convenor.

Past Presidents and President with Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court and Shri Dinesh Vyas, Senior Advocate, Supreme Court. Seen from L to R: S/Shri Sujal Shah, Paras K. Savla, Kishor Vanjara, A. S. Merchant, S. N. Inamdar, P. C. Joshi, Yatin Desai, Manoj Shah, Ajit Rohira, Hitesh R. Shah, President, Sharad Dalal, Bhavesh Vora, Vipin Batavia, K. Gopal, Parimal Parikh and Avinash Lalwani.



Office Bearers with Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court and Shri Dinesh Vyas, Senior Advocate, Supreme Court. Seen from L to R: S/Shri CA Haresh Kenia and CA Hinesh Doshi, Hon. Jt. Secretaries, CA Hitesh R. Shah, President, Ajay Singh, Vice President and CA Parag Ved, Hon. Treasurer.

Section of members

INDIRECT TAXES COMMITTEE

Orientation Course on "GST Model Law"
held on 16th, 21st, 22nd and 23rd September, 2016 at Jai Hind College.

CA Hitesh R. Shah, President delivering opening speech. Seen from L to R: S/Shri CA Vikram Mehta, Chairman, CA A. R. Krishnan, Advisor & Faculty and CA Naresh Sheth, Vice Chairman.

Shri Vikram Mehta, Chairman welcoming the speakers. Seen from L to R: S/Shri CA A. R. Krishnan, Advisor & Faculty, CA Hitesh R. Shah, President and CA Naresh Sheth, Vice Chairman.

CA Hitesh R. Shah, President and CA Vikram Mehta, Chairman inaugurating the session by lighting the lamp. Seen from L to R : CA Naresh Sheth, Vice Chairman and CA Manish Gadia, Member.

Section of delegates.

Faculties

CA A. R. Krishnan

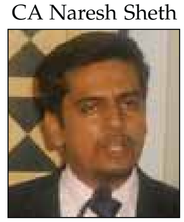
CA Sunil Gabhawalla

CA Rajiv Luthia

CA Naresh Sheth

CA S. S. Gupta

CA Mandar Telang



Mr. Harsh Shah, Advocate

CA Rajat Talati

Mr. L. Badri Narayan, Advocate

Indirect Tax Study Circle Meeting on "Rule 6 of CENVAT Rules" held on 13th September, 2016 at IMC.

CA Bharat Shemlani addressing the Members.

STUDENT AND IT CONNECT COMMITTEE

Lecture Meeting on "Important Provisions of Tax Audit and Tally as Audit Tool" held on 13th September, 2016 at Maheshwari Bhavan.

CA Hitesh R. Shah, President delivering opening speech. Seen from L to R : S/Shri CA Parimal Parikh, Chairman, CA Ankit Sanghv, Faculty, CA Amit Purohit, Faculty and CA Pranav K. Jhaveri, Member.

CA Parimal Parikh, Chairman welcoming the speaker.

Faculties

CA Amit Purohit

CA Ankit Sanghvi

Programme on "A Step Towards Cashless Economy : Unified Payment Interface" held on 14th September, 2016 at IMC.

CA Parimal Parikh, Chairman welcoming the speaker. Seen from L to R : S/Shri Sanjay Saxena, Faculty, CA Hitesh R. Shah, President, CA Alok R. Jajodia, Member, CA Maitri Savla, Convenor – IT.

Shri Sanjay Saxena addressing the delegates.

DELHI CHAPTER

Full Day Seminar on "M & A and Corporate Restructuring – Legal, Tax & Practical Aspects" held on 17th September, 2016 at India International Centre, New Delhi.

Mr. Inder Mohan Singh addressing the delegates. Seen from L to R: Mr. Abid Hussain, Faculty, Ms. Sadia Khan, Faculty, CA Hitesh R. Shah, President and Mr. V. P. Verma, Advisor.

Faculties

Ms. Sadia Khan

Mr. Abid Hussain

Mr. Amithraj AN

Section of delegates

LAW & REPRESENTATION COMMITTEE

DETAILED REPRESENTATION MADE ON DIRECT TAX BEFORE THE TAX SIMPLIFICATION COMMITTEE CHAIRED BY HON'BLE SHRI JUSTICE R. V. EASWAR, FORMER JUDGE, DELHI HIGH COURT ON 8TH OCTOBER, 2016 AT IMC.

Seen from L to R: S/Shri Paresh P. Shah, Chairman, International Taxation Committee, Yogesh Thar, Member, Mahendra Sanghvi, Chairman, Law & Representation Committee, Hitesh R. Shah, President, Paras K. Savla, Co-Chairman, Law & Representation Committee, and Ajay Singh, Vice President.

Seen from L to R: S/Shri Yogesh Thar, Member, Mahendra Sanghvi, Chairman, Law & Representation Committee, Hitesh R. Shah, President, Paras K. Savla, Co-Chairman, Law & Representation Committee, and Ajay Singh, Vice President.

Seen from L to R: S/Shri Ravi Gupta & Mukesh Patel, Members, Easwar Committee, Ketan Dalal, Chairman, Direct Taxes Committee, IMC, Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court, Pradip P. Shah & Vinod Jain, Members, Easwar Committee.

Seen from L to R: S/Shri Ravi Gupta & Arbind Mody, IRS, Members, Easwar Committee, Ketan Dalal, Chairman, Direct Taxes Committee, IMC, Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court, Pradip P. Shah & Vinod Jain, Members, Easwar Committee.

Hon'ble Shri Justice R. V. Easwar, Former Judge, Delhi High Court addressing the Members. Seen from L to R : Shri Pradip P. Shah.

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