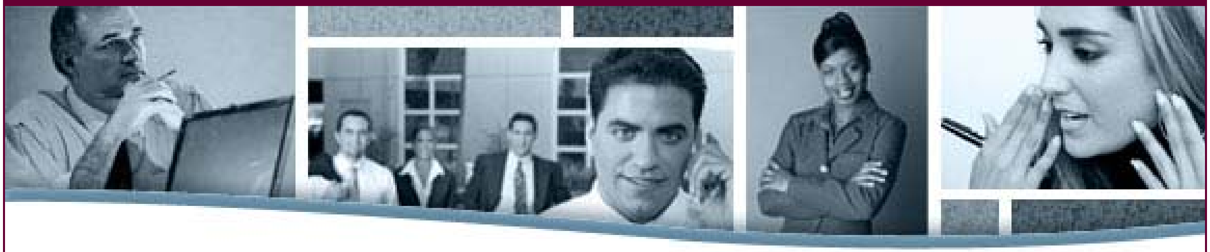
SEPTEMBER, 2015



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DIRECT TAX UPDATE

SUMMARY OF JUDGEMENTS

Transfer pricing and International taxation issues

1. Rampgreen Solutions Pvt Ltd Vs CIT (IT Appeal No 102/2015)

KPO services are not comparable to BPO services for identifying comparables for benchmarking an international transaction & determining the ALP.

2. Infogain India Pvt Ltd Vs DCIT (ITA No. 6134/Del/2012)

Circumstances in which the Profit Split Method (PSM) has to be preferred over the TNMM for determining the ALP

Domestic case laws:

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Penalty cannot be levied when all facts are disclosed in the Return of income which is also supported by a legal opinion.

3. Simran Singh Gambhir Vs. Deputy Director of Income Tax (International tax) (ITA No. 1336 & 3072/Mds/2014)

Penalty cannot be levied merely because, due to bonafide mistake, income was offered under a different head.

4. CIT Vs Hind Agro Industries (IT Appeal No 418/Chd/2015)

Once the books of account are rejected and gross profit is estimated, further disallowance of expense cannot be made.

<u>Transfer pricing and International taxation issues</u>

1. Rampgreen Solutions Pvt Ltd Vs CIT (IT Appeal No 102/2015)

KPO services are not comparable to BPO services for identifying comparables for benchmarking an international transaction & determining the ALP

Facts of the case:

The assessee is a wholly owned subsidiary of USA, engaged in providing voice-based customer care to the AE's clients. In consideration for the services, the AE remunerates the assessee by payment of all costs incurred by the assessee plus a mark- up of 15% of the costs. For the purposes of the transfer pricing study, the assessee had chosen eight comparable entities and the arithmetic average of the operating profit margins of the said comparables was computed to 15.74% and therefore its profit level indicator (PLI) was within the acceptable range. But when the matter was referred to the TPO, the TPO accepted the method adopted by the assessee (i.e. Transaction Net Marginal Method (TNMM)), but rejected the benchmarking report. The TPO identified different set of comparables companies for the purposes of determining the ALP and added two KPO companies namely - 'eClerx' and 'Vishal'.

Even the DRP rejected aggrieved assessee's contentions with regard to the exclusion of eClerx and Vishal contending that these companies were also providing Information Technology Enabled Services (ITeS) and, thus, could be used as comparables.

Aggrieved by the decision, the assesse appealed before ITAT where the assessee's contention was again rejected and held that once a service falls within the category of ITes, then no sub-classification of the segment was permissible. KPO is a term given to the branch of BPO Services where apart from processing of data, knowledge is also applied.

Decision of Hon'ble High Court:

On appeal before Hon'ble High Court, it was held that comparing controlled transactions/entities with similar uncontrolled transactions/entities is fundamentally irrational. ITes could include rendering highly technical services by qualified technical personnel, while, on the other end it would also include voice-based call centres that render routine customer support for their clients. Characteristics of the service rendered would be dissimilar and both the service providers cannot be considered to be functionally similar.

Thus, treating the said entities to be comparable only for the reason that they use Information Technology for the delivery of their services would be erroneous.

2. Infogain India Pvt. Ltd vs DCIT (ITA No. 6134/Del/2012)

Circumstances in which the Profit Split Method (PSM) has to be preferred over the TNMM for determining the ALP.

Facts of the case:

The assessee was engaged in the business of software development declaring its income of Rs. 1,41,28,871/- which was processed u/s 143(1) of the Income-tax Act, 1961 ("the Act"). The Group Companies in India was responsible for delivery of services to the customers globally. The primary objective of the group was to bring synergies amongst geographic groups and project, to make efficient use of the available resources, to broaden areas of service offerings, to improve opportunity fulfilment ration, and to maximize customer satisfaction with each project execution.

The method selected by the assessee was Profit Split method (PSM), while the A.O had claimed Transaction Net Marginal Method (TNMM), while working out the Arm's length value in respect of international transactions between assessee and parent company. The AO referred the matter to the TPO u/s 92CA (3) of the Act who proposed an addition of Rs. 16,86,58,151/-

The assessee filed objections before to the Dispute Resolution Penal (DRP) which was disallowed. Aggrieved by the decision, the assessee filed an appeal before Tribunal. .

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal while deciding in favour of Assessee held as under:

- On perusal of the function of the assessee company, it was revealed that the international transactions were highly integrated and interrelated and both the entities were contributing significantly to the value chain of provision of software services to the end customers. However, the TPO had not considered the role of the group companies.

- The assessee had assigned weights to each activity keeping in view the relative importance in the entire value chain, based on interviews with the key management personnel and the functions in the value chain of software services provided by the group companies to the customers based in the US were identified and weights were assigned to the functions having regard to their relative importance in the value chain. Both the parties, assessee and parent company were making contribution.

Therefore, the Profit Split Method was the most appropriate method for determination of ALP. The decision as what is the most appropriate method does not depend on the fact as to whether an assessee is having loss or has a profit.

<u>Domestic Case Laws:</u>

1. Shri Hasmukh N. Gala Vs. Income Tax Officer, Mumbai (ITA No. 7512/Mum/2013)

Giving 'advance' to the builder constitutes purchase of new house even if construction is not completed within prescribed period.

Facts of the case:

The assessee is engaged in the business trading in glass. The assessee had sold a property for a total consideration of Rs. 1,02,55,000/-. The relevant capital gain was claimed as under section 54 of the Act on the strength of having acquired a new residential house. The investment in acquisition of the new residential house was claimed by the assessee based on an advance of Rs.1.00 crore given to the builder as booking advance.

The Assessing Officer noted that in the instant case, even after two years of the date of transfer of old house the construction of the new property was not completed and that assessee had not gained possession of the new premises also. He, therefore, disallowed the exemption claimed u/s 54 of the Act.

The assessee appealed to the Commissioner of Income tax (Appeals) [CIT(A)]. Wherein, CIT(A) upheld the order of AO.

Aggrieved by the order of CIT(A), Assessee preferred appeals to the Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal while deciding in favour of Assessee held as under:

- The Hon'ble Tribunal held that the word 'purchase' used in Section 54 of the Act should be interpreted pragmatically. The intention behind Section 54 was to give relief to a person who had transferred his residential house and had purchased another residential house within two years of transfer or had purchased a residential house one year before transfer.

- The Hon'ble Tribunal relying on the decision of the **Hon'ble Delhi High Court in case of Shriram Agarwal (CIT vs. Kuldeep Singh, 270 CTR 561 (Del)** opined that when substantial investment was made in the new property, it should be deemed that sufficient steps had been taken and it would satisfy the requirements of section 54 of the Act.

Thus, claim for exemption u/s 54 of the Act cannot be denied merely because the new residential house was not completed within the stipulated time.

2. Pr. Commissioner of Income Tax Vs. Control And Switchgear Contractors Ltd. (ITA No. 290 of 2015)

Penalty cannot be levied when all facts are disclosed in the Return of income which is also supported by a legal opinion.

Summary of the case:

The assessee had received compensation in lieu of agreeing not to use the name after an interim period i.e. to give up the benefit over a period of time, of being known in the market as a joint venture partner of TE. And pursuant to obtaining a written opinion, it concluded that such receipt was not liable to tax. The AO rejected this explanation of assessee and initiated penalty proceedings against the assessee under section 271(1)(C) of the Act.

Levy of penalty was also confirmed by CIT(A) and ITAT.

Decision of the Hon'ble High Court:

The Hon'ble High Court while deciding in favour of assessee held as under:

- The Hon'ble High Court held that assessee had no intention to not disclose its true income.
- Further it stated that, that Explanation 1 to Section 271(1)(c) of the Act was not attracted as this was not a case of an assessee furnishing inaccurate particulars.

Thus, any claim made which is wrong on merits, does not attract penalty if facts were adequately disclosed in the return of income and was supported by a legal opinion.

3. Simran Singh Gambhir Vs. Deputy Director of Income Tax (International tax) (ITA No. 1336 & 3072/Mds/2014)

Penalty cannot be levied merely because, due to bonafide mistake, income was offered under a different head.

Summary of the Case:

The assessee had received income from the sale / maturity of National Housing Bond and offered the same to tax under the head long term capital gain. The AO chose to tax the same under the head 'income from other sources'. And initiated penalty proceedings under section 271(1)(c) of the Act.
Levy of penalty was also confirmed by CIT(A).

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal while deciding in favour of assessee held as under:

- The Hon'ble Tribunal held that it was a bonafide mistake on the part of the assessee. Also, all the information was adequately disclosed in the return of income.
- Merely because the income is offered to tax under a different head due to a genuine mistake, penalty could not be levied.

Thus, offering income for tax under a different head, due to a bonafide mistake, is not a sufficient ground to levy penalty

4. CIT Vs Hind Agro Industries (IT Appeal No 418/Chd/2015)

Once the books of account are rejected and gross profit is estimated, further disallowance of expense cannot be made.

Facts of the case:

The assessee is a manufacturer of harvester combines. During the assessment proceeding assessee failed to produce the books of accounts such as cash book, ledger, day book, purchase and sale bills and expenditure bills as asked for by the A.O. The gross profit rate had declined to 10.59% from 11.28% and 11.09% in assessment year 2008-09 and 2009-10 respectively.

Also, the brokerage of Rs 24,50,000/- had been debited to profit and loss account but no agreement in respect of brokerage paid had been produced. Further, disallowance u/s 40(a)(ia) of the Act was made by A.O as payment of Rs. 51,945/- was made towards advertisement expense and no TDS was deducted u/s 194C of the Act.

On appeal before CIT(A), the CIT(A) rightly rejected the books of account u/s 145(3) of the Act and estimated the gross profit rate to be 11.5% for the relevant assessment year. Also disallowance of advertisement expense was upheld.

Decision of Hon'ble Tribunal:

On appeal before Tribunal, the assessee preferred not to press the ground related to rejection of books of accounts. Further, the estimated of Gross Profit at the rate of 11.5% was upheld but further no other expenses were disallowed relying on the decision of Hon'ble High Court of Andhra Pradesh in the case of **Indwell Constructions V/s. CIT[(1998) 232 ITR 776].**

Thus, when the books of account are rejected and gross profit is estimated, it is deemed that all the deductions are taken into account while making such estimation. Hence no separate disallowance of expenses can be made.