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India Tax Newsletter | February 2016

In this edition of our thought leadership publication, we have tracked the progress of some significant cases decided by the appellate forums across the country, in 2016.

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A. International tax

1. Group reorganization

Sale of shares of an Indian company by a non-resident to a non-resident under group reorganization is not taxable in India

Case law 1: In Re Dow AgroSciences Agricultural Products Ltd

The applicant, Dow AgroSciences Agricultural Products Limited ('the applicant' or 'DAS Mauritius'), a tax resident of Mauritius had acquired shares of Dow AgroSciences India Private Limited, ('DAS India') a company incorporated in India on a progressive basis from 1995 to 2005. The applicant proposed to transfer these shares to a Group entity, DAS Singapore, incorporated in Singapore as contribution towards the capital in DAS Singapore. Consequently, through this arrangement, DAS India would now become the subsidiary of DAS Singapore.

The explanation provided by the applicant before the Authority for Advanced Ruling **('**AAR') for the proposed reorganization was that the Group had a presence in several countries across the world and the said reorganization would result in improved efficiency and reduction in costs for the Group as a whole.

The applicant, DAS Mauritius had proposed the following 7 questions before the AAR to which the AAR responded as below:

Question 1: Whether on the facts and circumstances of the case, the investment held by the Applicant in equity shares of DAS India would be considered as 'capital asset' under section 2(14) of the Act?

Based on the Instruction no. 181-1-89-IT(AI) dated 31-08-1989 and Supplementary Circular no. 2/2007 dated 15-06-2007 issued by the Central Board of Direct Taxes ("CBDT") for distinguishing shares held as stock in shares and those held as investments, and applying the 3 key tests(i.e. accounting, intention and quantum test), it was held that the shares held in DAS India would be a capital asset.

Question 2: Based on the facts and circumstances of the case, whether capital gains arising from the proposed transfer of shares of DAS India by the Applicant to DAS Singapore (a company proposed to be incorporated in Singapore), would be subject to tax in India?

Relying on the provisions of Article 13(4) of the Indo-Mauritius DTAA and the decision of the AAR in case of JSH Mauritius Ltd. the AAR held that there would be no taxation of capital gains in India.

Question 3: Based on the facts and circumstances of the case, if the answer to Question 1 is in the negative, whether the gains arising to the Applicant from the proposed transfer of equity shares of DAS India will be taxable in India in the absence of a Permanent Establishment of the Applicant in India and in light of the provisions of Article 7 read with Article 5 of the India Mauritius Double Taxation Avoidance Agreement

Since there was a specific finding by the AAR based on facts of the case and the TRC produced by the applicant that there was no PE of the applicant in India, this question was not required to be answered by the AAR.

Question 4: If the answer to Question 2 is negative, whether the Applicant would be liable to pay minimum alternate tax under the provisions of section 115JB of the Act?

The Supreme Court in case of Castleton Investment Ltd. had held that section 115JB of the Income Tax Act(1961) was not applicable to FIIs/FPIs having no PE in India. Further, CBDT Instruction no. 9/2015 dated 02-09-2015 had also held that the FIIs/FPIs having no PE / business connection India would not be covered by section 115JB of the Act. Thus, in the instant case, since the applicant did not have a PE in India, the AAR held that section 115JB of the Act was not applicable.

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Question 5: Based on the facts and circumstances of the case, if the proposed transfer of shares by the Applicant to DAS Singapore is not taxable, whether the provisions of section 92 to section 92F of the Act relating to transfer pricing would still be applicable?

As the transaction of transfer of shares was not chargeable to tax in India, it was held that section 92 to 92F of the Act was not applicable in light of the decisions of the AAR in case of Dana Corporation, Praxair Pacific Limited and Vanenburg Group BV.

Question 6: Based on the facts and circumstances of the case, if the proposed transfer of shares by the Applicant to Dow Singapore is not taxable, whether the sale consideration receivable by the Applicant should suffer any withholding tax as per section 195 of the Act?

Since the capital gains on transfer of shares would not be chargeable to tax in India, there would be no withholding requirements u/s 195 of the Act.

Question 7: Based on the facts and circumstances of the case, if the proposed transfer of shares of DAS India is not taxable in India, whether the Applicant is required to file any return of income under section 139 of the Act?

Relying on the decisions of the Federal Court in case of Chatturam Vs. CIT, Factset research Systems Inc. and Vanenburg Group BV, since the transaction of transfer of shares is not chargeable to tax in India, the applicant is not required to file a return of income u/s 139(1) of the Act.

The authority had also placed arguments with respect to the tax avoidance scheme employed by the applicant with respect to the treaty shopping done by the applicant. However, based on the facts and circumstances of the case, the AAR while dismissing the arguments of the Revenue held that the transaction began almost 20 years back and was done with all the approvals of the RBI and the Department of Industrial Policy and Promotion. Further, the shares were acquired at a substantial cost and the scheme of re-organisation was undertaken only with a view to achieve better control and reduces the overall costs of the Group as a whole.

2. Permanent establishment (‘PE’)

Article 7 r.w. Article 5 of India-Singapore DTAA - An installation project which does not last more than 183 days in a fiscal year is not a "Permanent Establishment".

Summary of the case:
The applicant is engaged in the business of heavy lifting and erection and installation of heavy equipment for large projects. The applicant has its activities in many countries across Asia. The applicant imported two cranes in India during the year under consideration. The project executed by applicant continued for a period of 178 days; also, it did not have any Permanent Establishment in India.

Ruling of the AAR:
Since applicant’s project in India was for a duration of less than 183 days, Permanent Establishment of the applicant cannot be constituted in India for the year under consideration as per the provisions of Article 5.3 of the India-Singapore DTAA.
Further, as per the provisions of Article 7 of the India-Singapore DTAA, business profits accruing or arising to the applicant by way of the execution of the project under reference is taxable only in the country where the applicant is a resident i.e. Singapore.

3. Fees for technical services

Managerial services rendered by a UK Company to an Indian Company, even if technical in nature, is not assessable as “fees for technical services” under Article 13 of India-UK DTAA if it does not “make available” any skill, technical know-how

Case Law 1: Authority of Advance Rulings (A.A.R. No1152 of 2011).

Summary of the case:
The applicant, Cummins Limited is a UK Company. Cummins Technologies India Limited (‘CTIL’) is an Indian company engaged in the business of manufacture and sale of turbochargers. CTIL purchases turbocharger components directly from third party in UK and US and in relation to such purchases, Cummins Limited provides supply management services. The applicant does not have permanent establishment (‘PE’) in India in respect of the supply management services as per the provisions of the India-UK Treaty. Thus, the applicant mentions that supply management services do not qualify either as Fees for Technical Services (‘FTS’) under Article 13(4) of India-UK Treaty or Royalty under Article 13(3) of the India-UK Treaty.

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To this the authority argued that turbocharger is a technical industrial product and for rendering supply management services for purchase of components of turbocharger the applicant has to use its technical knowledge and expertise. It concludes that the technical services were made available to CTIL. The Revenue also contended that the applicant has entered into contract with CTIL with an intention to take benefits of the India-UK Tax Treaty.

Ruling of AAR:
The objection of the authority was that the applicant has entered into contract with CTIL to take benefit of India – UK Tax Treaty and avoid tax is factually incorrect as the main purpose was to maintain Global Cummins contract supply agreement with the suppliers. Further, the supply management service provided by the applicant does not impar any technical knowledge and expertise to CTIL based on which it will acquire such skills and will be able to make use of it in future. Therefore, the 'make available' clause under India-UK Treaty is not satisfied. Also, it cannot be considered as royalty and covered under the ambit of Article 13 under India-UK Tax Treaty because it is not related with the use of, or the right to use any copyright, patent, trademark, design or modal, plan, secret formula or process etc.

4. Taxation of settlement amount

Settlement amount received by the trustee under the settlement agreement will not be taxable

Case Law 1: (A.A.R. No 1364, 1370 & 1433 of 2012)

Whether, on the facts and circumstance of the case, the Settlement Amount received by the trustee for the Claims trusts in accordance with the terms of the Settlement Agreement taxable under the provisions of the Act?

To this, the AAR contends that the nature of settlement agreement is that of capital receipt and it cannot be categorized as income. The Impugned Settlement Amounts are received on account of destruction of capital assets (i.e against surrender of right to sue) and thus do not fall for consideration under section 45 of the Act. Further, no Capital Gains arise owing to failure of computation mechanism under Section 48 of the ITA and Section 48 of the ITA and Section 55 (3) of the Act.

Also, it stated that the settlement account received as against surrender the 'right to sue' cannot be linked with income generating apparatus. It can also not be said that it relates to any sort of business activity carried on. Once the character of receipt is capital in nature, it goes outside the scope of income chargeable to tax unless it is specifically brought within the ambit of income by way of specific provisions of the Income-tax Act.

Thus, the amount received by a Foreign Institutional Investors ('FII') under a settlement for giving up right to sue is not assessable as either capital gains or as business profits. In principle, a FII is an "investor" and not a "trader" in stocks and hence, settlement amount received will not be taxable pertaining to the facts of the case.

B. Domestic taxation

1. Capital subsidy

Subsidy granted to set up a wind project is a capital receipt and hence not taxable

Case Law 1: M/s. UniDeritend Limited Vs. Additional Commissioner of Income Tax (ITA No.3473/M/2013)

Summary of the case:
The assessee had installed wind energy project at a cost of INR.1189.87 lakhs in F.Y 2001-2002. As per the policy of Maharashtra Government, to promote generation of energy through non-conventional sources to supplement the ever increasing demand of the electricity in the state, the wind power projects have been granted status of small scale industries and the state government gives the capital subsidy up to 30% of the fixed capital investment to the promoters subject to a condition that wind power plant has successfully operated with a minimum 12% plant load factor for at least one year.

The assessee accordingly applied for the said capital subsidy which was granted to the assesse in F.Y 2007-08 at INR.20 lakh and in F.Y. 2008-09, assessee had to refund back subsidy to the extent of Rs.10 lakhs on non-fulfilment of certain conditions.

To this the assessing officer held that the subsidy ought to be taxed u/s 50 of the Act as short term capital gain as the written down value of the asset was NIL and accordingly made additions in the assessment of the assessee.

The CIT(A) held that the subsidy received by the assessee should be taxed u/s 41(1) of the Act. Aggrieved by the decision, the asseese appealed before Hon'ble Tribunal.

Decision of the Hon'ble ITAT

Relying on

- CIT vs. Reliance Industries Ltd. (339 ITR 632) (Bom.); and
- CIT vs. Ponni Sugars and Chemicals Ltd. (306 ITR 392) (SC)

The ITAT held that the subsidy was to set up a new unit in a backward area to generate employment therein, so it is to be treated on capital account and the sales tax incentive was to be treated as capital receipt.

As regards the assessing officer applicability of section 50 of the Act, it was held that, in this case it was neither the transfer of any asset from the block nor did the block cease to exist. It is only applicable in the case of capital receipt.

Further section 41(1) of the Act is concerned with the benefit received on account of loss, expenditure or trading liability and not in respect of capital receipts. Thus subsidy received will not be covered under the ambit of prevailing section.

In view of the foregoing, the subsidy received by the assessee was held to be not taxable u/s 41(1) as well as neither u/s 43(1) and nor u/s 50 of the Act.

Case Law 2: Yum Restaurants (India) Private Limited Vs. Income-tax Officer (ITA No. 388 of 2015)

Transfer of shares leads to a change in the beneficial ownership of shares thereby leading to a disallowance of brought forward losses. Mere argument that the ultimate holding company continues to remain the beneficial owner of shares does not hold good

Summary of the case:
During the year under consideration, there was a 100% change in the shareholding of the assessee i.e. the entire shareholding was transferred by Yum Asia to Yum Singapore. The assessing officer observed that the requirement of Section 79 was that the shares should be beneficially held by the company carrying 51% of voting power at the close of the financial year in which the loss was suffered and denied the set off and carry forward losses.

The assessee contended that shares were transferred not withstanding the fact that ultimate beneficial owner of the shares remained same.

The assessing officer disallowed the claim and the same was further upheld by CIT[A]. Aggrieved, the assessee preferred an appeal before the Hon'ble Delhi Tribunal.

Decision of the Hon'ble Delhi Tribunal
The Hon'ble Delhi Tribunal while deciding against the assessee held as under:

There is nothing to show that there was any agreement or arrangement that the beneficial owner of such shares would be the holding company; andthere was indeed a change of ownership of 100% shares of Yum India from Yum Asia to Yum Singapore, both of which were distinct entities.

In view of the above, the ITAT held that the corporate veil cannot be pierced at the instance that ultimate beneficial owner of the shares remained same.

2. Computation of net worth in case of slump sale

Depreciation on assets have to be deducted, while calculating net worth for the purpose of computing capital gain on slump sale, even if the same is not claimed by assessee.

Case Law 1: Commissioner of Income Tax Vs. Dharampal Satyapal (ITA 1003/2011)

Summary of the case:
The assessee transferred its entire business by way of a slump sale to M/s Dharampal Satyapal Ltd. on 12th February, 2001 (during the previous year relevant to the AY 2001-02) at a net consideration of INR. 2.75 crores. The assessee had not claimed any depreciation on its assets for the previous year ended 31st March, 2000. Accordingly, the block of assets was reflected by the assessee in its books of account at the actual cost of acquisition. The assessing officer was of the view that for the purposes of calculating the net worth of the undertaking, by importing the interpretation of section 43, depreciation allowable would have to be deducted even though no such depreciation had been claimed by the assessee.

On appeal, CIT(A) upheld the order of assessing officer. On further appeal, the Hon'ble Tribunal decided the matter in favour of assesse against which assessing officer appealed at the Hon'ble Delhi High Court.

Decision of the Hon'ble Delhi High Court
The Hon'ble Delhi High Court held as under:

The purpose of clause (a) of Explanation 2 to Section 50B of the Act is to provide a methodology to compute the written down value of the block of assets transferred by an assesse as a part of the undertaking or division sold by way of a slump sale;

The machinery provisions provided in Section 50B of the Act exhaustively provide for determining the cost of acquisition of the undertaking or division sold by way of a slump sale;

There is no provision which mandates adopting that for calculating net worth, the written down value must be taken as existing in the books of account.

Thus, for computing net worth, depreciation has to be deducted from block of assets, even if the same is not claimed by the assesse.

3. Purchase of software is not Royalty

Payments made for purchase of software as a product is not for use or the right to use the software and is not assessable as "royalty".

Case Law 1: Commissioner of Income Tax Vs. M Tech India Pvt Ltd (ITA 890/2015)

Summary of the case:
The assessee had made payment for purchase of software and it was asserted that the assessee was a Value Added Reseller ('VAR') of the software. The assessing officer on the other hand held that the payments made by the assesse were in the nature of royalty and, therefore, the assessee was obliged to withhold tax on such payments. Since the assessee had failed to do so, the expenditure incurred by the assesse was liable to be disallowed under Section 40(a) of the Act. The assessee claimed that similar purchases made in the preceding years had been considered as purchases and allowed as a deduction in computing its taxable income.

On appealing before CIT(A), the CIT(A) held that that the payments made by the assessee was for the purchase of software and cannot be considered as royalty.

Aggrieved by the decision, the A.O appealed before ITAT, wherein the Hon'ble Tribunal upheld the decision of CIT(A) after relying on the decision of **CIT v. Dynamic Vertical Software India P. Ltd (2011) 332 ITR 222 (Del).**

Decision of Hon'ble High Court

On appealing before the Hon'ble High Court, it was held that the assessee was appointed for reselling the software. In the cases where an assessee acquires the right to use a software, the payment so made would amount to royalty. However, in cases where the payments are made for purchase of software as a product, the consideration paid cannot be considered to be for use or the right to use the software. While rendering the decision for the same, reliance is also placed on the decision of **Tata Consultancy Services Vs. State of Andhra Pradesh (2004) 271 ITR 401 (SC)**.

Thus, it is necessary to make proper distinction between the cases where consideration is paid to acquire the right to use a patent or a copyright and cases where payment is made to acquire patented or a copyrighted product / material.

4. Reopening of assessment

Instruction No. 9/2006 of CBDT dated November 07, 2006 cannot override section 147 of the Act which requires AO to form his own belief regarding income escaping assessment.

Case Law 1: Sun Pharmaceuticals Industries Limited Vs. Deputy Commissioner of Income Tax (W.P.(c) 6729/2011)

Summary of the case:
Based on the audit objections, the assessing officer sought to reopen the assessment of the assessee issued notice under section 148 to take remedial measures as a result of Instruction No. 9/2006. Further, it was stated by the assessing officer that the assessee has failed to disclose all material facts truly and fully that were necessary for assessment.

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Decision of the Hon'ble Delhi High Court
The Hon'ble Delhi High Court held as under:

The CBDT has issued the instructions so that management and processes relating to audit objections are streamlined with a greater sense of accountability.

However, the decision to reopen the assessment had to be taken by the assessing officer alone and no one else. In other words, the assessing officer could not have been subject to any compulsion in the form of an instruction by the CBDT to take a decision with regard to reopening of the assessment in terms of Section 147 of the Act. The proviso (a) to Section 119(1) of the Act makes it clear that there cannot be any such orders, instructions or directions of the CBDT which "require any income tax authority to make a particular assessment or to dispose of a particular case in a particular manner".

Further, the assessing officer did not point out which particular material was not disclosed in the course of the original assessment by the assessee.

Thus, reopening of assessment to take remedial action pursuant to audit objections as per Instruction No. 9 of 2006 is not valid.

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