APRIL, 2015

DIRECT TAX UPDATE

SUMMARY OF JUDGEMENTS

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1. **Transfer pricing and International taxation issues**

Aditya Birla Minacs Worldwide Ltd. Vs. DCIT (ITA No. 7033/Mum/2012)

- The appropriate ALP for guarantee commission in respect of corporate guarantee given on behalf of AE and rate of interest charged for loan advanced to the wholly owned subsidiary may be taken at 0.5% and LIBOR + 2% respectively;
- Mere delay in issue of shares subsequent to receipt of share application money cannot conclude the same to be in nature of loan.

Everest Kanto Cylinder Ltd. Vs. CIT (ITA No. 550/Mum/2014)

- Disallowance cannot be made under section 14A of the Act when investment is made out of non-interest bearing funds and also when amount is invested in foreign subsidies;
- Guarantee commission should be charged to all the associate enterprise for all international transaction within the arm's length;
- For appropriate international interest rates, the London Inter-Bank Offer Rate (LIBOR), which is an internationally recognized rate for benchmarking loans denominated in foreign currency rates, should be used for the purpose of the comparability analysis and not on the average yield rates considered by the TPO.

2. Domestic issues

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Jet Speed Audio (P.) Ltd. Vs CIT (IT Appeal No.285 of 2013)

Where Assessing Officer raised query with regard to bad debts claimed by assessee and after satisfaction passed original assessment order, re-assessment without recording any tangible material was unjustified.

3. Others

a. Acche Din! NAMO Cracks Whip on Income-Tax Department for harassing Taxpayers.

b. Twelve Income Computation and Disclosure Standards issued by Ministry of Finance to be followed by Assessees for computation of taxable income under "Profits and Gains from Business and Profession" or "Income from Other Sources".

c. Application for allotment of Permanent Account Number (PAN) no longer remains a cumbersome process. (Notification No 38 vide dated 10th April, 2015)

1. Transfer pricing and International taxation issues

a. Aditya Birla Minacs Worldwide Ltd. Vs. DCIT (ITA No. 7033/Mum/2012)

Facts of the Case:

The appropriate ALP for guarantee commission in respect of corporate guarantee given on behalf of AE and rate of interest charged for loan advanced to the wholly owned subsidiary may be taken at 0.5% and LIBOR + 2% respectively. Also, a mere delay in issue of shares subsequent to receipt of share application money cannot conclude the same to be in nature of loan.

The decisions given by the Tribunal in this case once again reaffirm the judgments given by various Hon'ble Tribunals across the country. The issues were as under:

- **The price of guarantee commission in respect of corporate guarantee given by the assessee for its Associated Enterprise (AE) at 0.5% may be considered as an appropriate Arm's Length Price (ALP).**

The AE of the Assessee had availed a loan for which, the assessee had given a corporate guarantee of INR 106.560 crores to the bank vide deed of guarantee, but did not classify the same as an international transaction. The AO considered the ALP of above transaction at 3.25%.

On appeal, the Commissioner of Income Tax (Appeals) ("CIT(A)") upheld the order of AO. Aggrieved by the order of CIT(A), assessee preferred appeal before the Tribunal.

Decision of Tribunal:

The Tribunal relying on the decision of Delhi Benches of the same Tribunal in the case of Bharti Airtel Ltd (ITA No 5816/Del/2012) and various others, deleted the adjustment made by the AO partly in favour of Assessee and considered the ALP of 0.5% for the above transaction as appropriate.

- **The ALP in respect of interest charged by the Assessee on the loan advanced to its wholly owned subsidiary may be considered appropriate at the rate of LIBOR + 2%.**

The Assessee advanced a loan to its wholly owned subsidiary in order to accomplish acquisition of another company. The interest charged by the Assessee was at the rate of LIBOR + 1% (as against the ALP determined vide TP study @ LIBOR + 0.65%). The AO did not accept the rate adopted by the Assessee and proceeded to make an adjustment by adopting the rate of LIBOR + 4.45% which comprised of 0.45% - base rate, 1% - fees, 3% - mark-up.

On appeal by the Assessee, the CIT(A) determined ALP of interest at LIBOR + 2% and accordingly reduced the adjustment. Aggrieved, the Assessee is in appeal at the Tribunal.

Decision of Tribunal:

The Tribunal placing emphasis on decisions of various other tribunals across the country and also in the case of Everest Kanto Cylinder Ltd. upheld the order of the CIT(A) and stated that LIBOR +2% is a reasonable interest rate to be adopted as ALP.

- **Mere delay in issuance of shares cannot render the money received in from of share application as a loan.**

The assessee had given a sum of money to its subsidiary as capital infusion in form of fresh capital. However, shares were not allotted for 2 subsequent years and the subsidiary continued to use the sum. Thus, the AO treated the same as a

loan and made an adjustment taking interest income in the hands of the Assessee at the rate of LIBOR + 4.45%.

On appeal, the CIT(A) upheld the order of AO. Aggrieved by the order of CIT(A), the assessee preferred the appeal before the Tribunal.

Decision of Tribunal:

The Tribunal placed emphasis on the fact that the delay in issuing the shares against the share application money given by the assesse to its AE was not deliberate as delay was due to obtaining necessary approval from the Securities and Exchange Commission, Phillipines. Thus, the Tribunal relying upon the decision of the Hon'ble Jurisdictional Bombay High Court in the case of DIT Vs. Besix Kier Dabhol S.A. (26 taxmann.com 169) (Bom), wherein similar issue was dealt with, deleted the adjustment made by AO in favour of the assessee.

b. Everest Kanto Cylinder Ltd. Vs. CIT (ITA No. 550/Mum/2014)

- **Disallowance cannot be made u/s 14A of the Act when investment is made out of non-interest bearing funds and also when amount is invested in foreign subsidies.**

Facts of the Case

The assessee earned dividend of Rs. 242,038/- which was claimed as deduction u/s 10(33) of the Act. The assessee had submitted the working of disallowance u/s 14A of the Act to the AO, which was not accepted by him. The assessee objected the proposed disallowance of Rs. 693,102 which was derived after applying Rule 8D as against interest and administration expense before the DRP. However, the DRP had sustained the disallowance made by the AO.

The assessee contented that investment was made out of

non-interest bearing fund. Further, for the A.Y. 2008-09, the investment was made in the foreign subsidiaries, and therefore, to this extent of investment, no disallowance will be made. Also, during A.Y 2009-2010, no fresh investments were made. It further submitted that, disallowance can be made only to the extent of administrative expense. Thus, the disallowance u/s 14A was made only to the extent of administrative expenses.

- **Guarantee commission should be charged to all the associate enterprise for all international transaction within the arm's length.**

Facts of the case

The assessee had provided guarantee to its associated enterprises namely EKC Dubai and EKC China for taking term loan from banks at the rate of 0.5% p. Apart from this, the assessee has also provided corporate guarantee to its USA enterprise, CP Industries to make overseas acquisition. The assessee had charged guarantee commission at the rate of 0.5% p.a from EKC Dubai, however, no guarantee commission was charged from EKC China because of the alleged regulations prohibiting such guarantee commission. Also, the assessee has not recovered any guarantee commission on the guarantee given to CPI USA on the ground that the loan taken by CPI was in the nature of quasi equity.

However, the TPO did not agree with the contention of the assessee and determined the arm length guarantee commission in respect of various guarantee provided by the assessee and made the adjustment accordingly.

The assessee challenged the proposed adjustment by raising the objection before the DRP. The DRP determined the ALP at the rate of 1% for the guarantee given to EKC Dubai, whereas 3% for the guarantee given to EKC China and CPI USA and also directed A.O to

restrict the adjustment. Thus, both the assessee as well as revenue were aggrieved by the directions of DRP and final order of Assessing Officer and filed cross appeals before ITAT.

Decision of Tribunal:

After hearing both the appeals, it was concluded that guarantee commission of 0.5% was within the arm's length but such commission is to be charged to all the three transactions of guarantee to its A.E at Dubai, China and USA.

- **For appropriate international interest rates, the London Inter-Bank Offer Rate (LIBOR), which is an internationally recognized rate for benchmarking loans denominated in foreign currency rates, should be used for the purpose of the comparability analysis and not on the average yield rates considered by the TPO.**

Facts of the Case

The assesse had provided loan to its A.E at Dubai and China and charges the interest rate on the same. Using the CUP method, the assessee had bench marked its transaction of providing loan to AE at Dubai at London Inter-Bank Offer Rate (LIBOR)+ 0.5%. The assessee has charged interest to its Dubai AE for one loan at 7% interest rate and LIBOR +1% in respect of remaining loan and for China, the assessee had bench marked the transaction in the range of 5.58% to 6.84%. Since the assessee has charged the interest at the rate of 7% from its AE at China, therefore, it claimed its transaction are at arm's length.

The TPO did not accept the arm's length price determined by the assessee and has determined the arm's length interest rate at 10.25% and made the respective additions.

The assessee raised objection before the DRP but could

not succeed as the DRP has upheld the adjustment proposed by the TPO/Assessing Officer.

The assessee further submitted that the loan were granted from the proceeds of zero coupon foreign currency convertible bonds which were interest free funds. He also submitted that providing the fund to the AE in the nature of share holders activity, therefore, providing assessee's own fund for financing 100% subsidiary for the benefit in the form of growth of his business in different countries does not require any transfer pricing adjustment. However the assessing officer mentioned that it makes no difference whether the fund was interest bearing fund or assessee's own fund when the transaction is an international transaction.

Decision of Tribunal:

Relying on

- Great Eastern Shipping Co.Ltd (ITA No 397/M/2012) dated 10 January 2014;
- Mahindra & Mahindra Limited (ITA No 7999/M/2011) dated 8 June 2012;
- Hinduja Global Solutions Limited (ITA No 254/M/2013) dated 5 June 2013

and several other case laws, it was concluded that for appropriate international rates, the LIBOR, which is an internationally recognized rate for benchmarking loans denominated in foreign currency rates, should be used for the purpose of the comparability analysis and not on the average yield rates considered by the TPO. Thus the arm's length rate in respect of loan granted to its A.E should be LIBOR + 2%. Hence as the rate of interest for loan granted to China is considered at 7%, it is within the arm's length. But for Dubai, it has to be recomputed for the purpose of TP adjustment.

2. Domestic Taxation

a. M/s Hinduja Global Solutions Ltd. Vs DCIT (ITA NO.1107/Mum/2014)

Expenditure towards entrance fees of a golf association to enable directors/Key personnel to develop contacts shall be allowed as a business expenditure.

Facts of the Case:

The Assessee had incurred expenses of Rs. 20 lacs in the nature of entrance fees of Karnataka Golf Association club. The Assessing Officer disallowed the expenses stating that expenses incurred were personal in nature.

Issue before the tribunal:

Whether expense incurred towards entrance fee of club be allowed as deduction?

Decision of the Tribunal:

After placing emphasis on the totality of facts and relying on the decisions of Hon'ble Apex Court in case of CIT vs United Glass Mfg. Co. Ltd. (2012) Civil Appeal No.6447 of 2012 and various others decision the Hon'ble Tribunal held the assessee paid the membership/entrance fee of the club by way of admission fee/corporate membership fee wholly and exclusively in the interest of the business, thus, it has to be allowed as business expenditure.

Therefore, entrance fees of club incurred to develop corporate contacts and promote business is allowed as business expenditure.

2. **M/s Jansampark Advertising And Marketing (P) Ltd. Vs CIT (ITA 525/Del/2014)**

Proof relating to genuineness of the transaction provided by the assessee does not necessarily follow satisfaction as

to the creditworthiness of the parties u/s 68 of the on cash credit

Facts of the Case:

The assessee had filed its return of income for AY 2004-05 declaring income of INR 3,180. In 2007, the Assessing Officer (AO) was in receipt of information from DIT (Investigation), New Delhi that the assessee had been in receipt of accommodation entries from the entry providers. Thus, having reasons to believe, the AO re-opened the case. On re-opening, it was found that assessee had raised share capital from various parties some of whom were engaged in the business of giving accommodation entries.

In the course of proceedings, the assessee discharged preliminary obligation of providing copy of application for subscription of shares, confirmations, return of allotment dated 29.06.2004 filed with ROC etc. The AO, in order to verify the genuineness, issued summons to which no one appeared and some of the summons came back unserved. Thus, the AO treated the same as unexplained credit and added the same to the income of the assessee.

Thus, the Assessee preferred appeals to the CIT(A) who dismissed the order of AO. Assailing the said order passed by CIT(A), the revenue filed an appeal in the Tribunal, who upheld the order of CIT(A). Aggrieved, the revenue referred appeal to the Hon'ble High Court.

Decision of the Hon'ble High Court held:

- The AO here has failed to discharge his obligation to conduct a proper inquiry to take the matter to logical conclusion. But CIT (A), having noticed want of proper inquiry, could not have closed the chapter simply by allowing the appeal and deleting the additions made.

- It was also the obligation of CIT(A), as indeed of ITAT, to ensure that effective inquiry was carried out, particularly in the face of the allegations of the Revenue that the account

statements reveal a uniform pattern of cash deposits of equal amounts in the respective accounts preceding the transactions in question. This necessitated a detailed scrutiny of the material submitted by the assessee in response to the notice under Section 148 issued by the AO, as also the material submitted at the stage of appeals by way of making further inquiry by remand report. This approach not having been adopted by ITAT, and consequently that of CIT (A), cannot be approved.

Therefore, the proof relating to genuineness of the transaction which was provided by the assessee does not necessarily follow that satisfaction as to the creditworthiness of the parties has been established and remitted back to CIT(A) with a direction for fresh consideration.

3. **JitendraMansukhlal Shah Vs CIT (ITA NO.2293/Mum/2013)**

Disallowance u/s. 40(a)(ia) for non-deduction of TDS applicable only to the amount payable at the end of the year and not on the amount already paid during the year

Facts of the Case:

The labour charges of Rs 9,793,037 paid by the asseesee has been disallowed on account of application of section 40(a)(ia) of the Act for the reason that assessee did not deduct tax at source u/s 194C of the Act.

Decision of the Tribunal Held:

- Relying on the decision of Hon'ble Allahabad High Court in the case of CIT vs. Vector Shipping Services (P) Ltd. ITA- 122/2013 (SC) And 262 CTR 545 (HC-All) the Tribunal has held that for disallowing expenses from business and profession on the ground that TDS has not been deducted, amount should be payable and not which has been paid by end of the year.

- Various views have been taken by High Courts of different

jurisdiction for the word "payable" used in section 40(a)(ia) of the Act. In the light of the decision of the Hon'ble Supreme Court in the case of 'Vegetable Products Ltd', it is held that as there are two views possible in this matter, the one in the favour of assessee has to be followed.

Thus, to the extent of labour charges paid during the year no disallowance will be made to that extent. Section 40(a)(ia) will comply only to the amount payable at the end of the year.

4. **Jet Speed Audio (P.) Ltd. Vs CIT (IT Appeal No.285 of 2013)**

Where Assessing Officer raised query with regard to bad debts claimed by assessee and after satisfaction passed original assessment order, re-assessment without recording any tangible material was unjustified

Facts of the Case:

The assessee-company was engaged in money lending business. It had written off certain sum as bad debts. During assessment proceedings, a query was made with regard to bad debts which was responded by the assessee. After satisfaction, the Assessing Officer passed assessment order. Subsequent to original assessment, a notice under section 154 was issued by the Assessing Officer seeking to rectify assessment order on the ground that amount written off as bad debts was a capital loss and could not be considered to determine income. Pending the disposal of rectification under section 154, the Assessing Officer issued a notice under section 148 seeking to reopen the assessment after recording that amount written off as bad debts was a capital loss and needed to add back to the taxable income.

On appeal, the Commissioner (Appeals) upheld the order of the Assessing Officer. On further appeal, the Tribunal cancelled the re-assessment order passed under section 147 holding that there was no tangible material mentioned in the

reasons recorded by the revenue. Aggrieved, the revenue referred appeal to the Hon'ble High Court.

Decision of the Hon'ble High Court held

- Reopening of assessment on an issue in respect of which a query was raised in original assessment proceedings and responded to by the assessee would amount to a change of opinion. The tangible material being urged is the audit objections received by the Assessing Officer. However, as would be clear from the reasons reproduced, there is no mention of any tangible material in the reasons recorded for issuing reopening notice under section 148. Thus, there is no fault with the findings of the Tribunal that there is no tangible material mentioned in the reasons recorded by the revenue which would warrant a different opinion being taken then which was taken when the original order of assessment was passed

- It is a settled position in law that a reopening notice can be sustained only on the basis of grounds mentioned in the reasons recorded. It is not open to the revenue to add and/or supplement later the reasons recorded at the time of issuing reopening notice.

- In the present case the reasons as recorded by the Assessing Officer clearly indicate that there was no tangible material adverting to the reasons recorded for issuing reopening notice. Similarly the decision of this Court in the case of "Dr. Amin's Pathology Laboratory" v. P.N. Prasad, Jt. CIT(252 ITR 673) (Bom.), it has been observed that if any item has escaped from assessment which otherwise is includible within the assessment and the Assessing Officer notices it subsequently by his own investigation or by reason of some information received by him, one cannot say that it constitutes change of opinion. In the present facts during original proceedings itself this issue was investigated by the Assessing Officer by raising specific query with regard to bad debts. Consequently, this is not a case where this information has been noticed by the Assessing Officer subsequently in the assessment proceedings.

Therefore, the reassessment is bad in law as there has been change of opinion in issuing the re-assessment notice without having any tangible material on record.

3.Others

a. Acche Din! NAMO Cracks Whip on Income-Tax Department for harassing Taxpayers

Prime Minister Narendra Modi (NAMO) has come to the rescue of beleaguered taxpayers. A terse note dated 26th March, 2015 was addressed by Hon'ble Ms. Anita Kapur, Chairperson of the CBDT, to the Income-tax department regarding the conference held with Revenue Secretary and NAMO. At the meeting, NAMO *expressed dissatisfaction about "delays in responding to public grievances by the officers*" and "*the harassment meted out to the taxpayers and officious behavior of the Officers*". He was assured that redressal of public grievances is one of the priority areas in the interim central plan which has laid down following timelines for disposal of public grievances as under:

- 30th April, 2015 for grievances pending for more than 1 year as on 31st March, 2015.
- 7th June, 2015 for grievances pending for more than 60 days as on 31st March, 2015.

NAMO also made it clear that he will be *personally monitoring* the status of public grievances on a monthly basis through PRAGATI programme. The Hon'ble CBDT Chairperson has directed all officers to give *utmost priority* to public grievances and to respond and attend to such grievances on *top priority*. At the end, she has issued a clear warning to the non-compliant officers for breach of timeline.

KNAV Comments: Such efforts of PM in this regard will help to report a much better position of disposal of public grievances.

b. Twelve Income Computation and Disclosure Standards issued by Ministry of Finance to be followed by Assessees for computation of taxable income under "Profits and Gains from Business and Profession" or "Income from Other Sources".

The Central Board of Direct Taxes (CBDT) vide notification no. 32/2015 dated March 31, 2015 issued revised draft of 12 Income Computation and Disclosure Standards (ICDS) to be followed by Assessees following mercantile system of Accounting with effect from April 1, 2015.

These standards shall have to be followed while computing income chargeable to tax under the head of "Profits and Gains from Business and Profession" or "Income from Other Sources".
The draft provides for transitional provision on ICDS applicability to be followed April 1, 2015 onwards. Further, the draft also states that in case of conflict between provisions of the Income-tax Act, 1961 ("the Act") and ICDS, provisions the Act shall prevail.

KNAV Comments: Much needed disclosure standards have been provided by the ICDS shall prove to be a roadmap for the alignment of provisions of the Act with the disclosure required.

c. Application for allotment of Permanent Account Number (PAN) no longer remains a cumbersome process. (Notification No 38 vide dated 10th April, 2015.

The Central board of Direct Tax (CBDT) issued a Circular No 38 vide dated on 10th of April,2015 amending the Income Tax Rules,1962.

The following provision shall be inserted in rule 114(1) namely
"Provided that in case of an applicant, being a company which has not been registered under the Companies Act, 2013 (18 of 2013), the application for allotment of a Permanent Account Number may be made in Form No. INC-7 specified under sub-section (1) of section 7 of the said Act for incorporation of the company."

Thus, this circular will prove to be a boon for non- residents as they can avoid the cumbersome process of applying for allotment of PAN through National Security Depository Limited (NSDL) as they will be allotted the PAN merely on fulfilling Form No INC-7 which is mandatory while incorporating the company in India under Companies Act, 2013.

KNAV Comments: This is a favorable step taken by the

government towards its goal of "Minimum Government, Maximum Governance".