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DIRECT TAX UPDATE

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Loans given to wholly-owned foreign subsidiaries out of interest-free funds needs to be bench-marked at LIBOR as it falls within the ambit of 'International Transaction'.

b. Honda Motorcycle and Scooter India Private Limited Vs. ACIT (ITA No.132/Del./2013)

TPO is to conduct a Transfer Pricing analysis to determine the Arm's Length Price (ALP) and not to determine whether there is a service from which assesse has derived benefit or not.

c. Birlasoft (India) Limited Vs. DCIT (ITA No. 200/Del/2015)

Internal benchmarking analysis could be used to determine the ALP for international transactions with AEs if transactions with

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Initiation of penalty proceedings stipulate collection of evidence to prove deliberate mistake of the assesse; mere voluntary surrender of income by the assessee cannot be the basis for levying penalty u/s 271(1)(c) of the Act.

b. Hirachand Kanuga Vs. DCIT (ITA Nos. 4261 & 4262 /Mum/ 2012)

Where Commissioner simply put 'approved' and signed report thereby giving sanction to Assessing Officer to reopen assessment, it did not amount to recording of proper satisfaction in terms of section 151(1) of the Act.

c. Mysore Intercontinental Hotels Ltd. Vs. ACIT (ITA No. 727 of 2009-Karnataka High court)

Facilities given by assessee along with let out buildings/commercial establishments were inseparable and entire construction and interiors of buildings was done with sole intention of carrying on business, entire income would be assessed as 'business income'

d. Kirti Dahyabhai Patel Vs. ACIT (ITA No. 1181 of 2010-Gujart High Court)

Section 271(1) of the Act does not specify any time limit during which the amount of penalty with interest has to be paid and immunity available under this section can be granted.

1. Transfer Pricing

a. Shrenuj & Company Limited Vs. ACIT (ITA No. 8189/Mum/2010 and 7948/Mum/2011)

Loans given to wholly owned foreign subsidiaries out of interest free funds need to be benchmarked at LIBOR as it falls within the ambit of 'International Transaction'

Facts of the case:

The assessee company is engaged in the business of manufacture of cut and polished diamonds and jewelery and in sale thereof including exports. During the scrutiny assessment, the A.O. referred the matter to the TPO wherein transfer pricing adjustment was sought on account of interest free loans given to wholly owned foreign subsidiaries.

The assessee contended that question of charging interest does not arise as the entire profits always belong to the ultimate holding company and further, assessee claimed the interest free loan to be at ALP as he had placed reliance on external comparables wherein, interest free loans were given to wholly owned subsidiaries.

Aggrieved by the TPOs order, 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 appeal to the Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal held as under:

- The loan given by assessee to its wholly owned subsidiary without charging interest comes within the purview of 'International Transaction.' It is irrelevant whether such loan was given out of interest free funds available at the disposal of the assessee.

- Placing reliance on decision of Hon'ble Jurisdictional High Court in case of **CIT vs. Tata Autocomp Systems Ltd., (IT Appeal No. 1320 of 2012)** directed the AO to make an adjustment on the said transaction by applying LIBOR.

Thus, loans given to wholly owned foreign subsidiaries was liable to be benchmarked even if the loan was advanced out of interest free funds available in the hands of assessee.

b. Honda Motorcycle and Scooter India Private Limited Vs. ACIT (ITA No.132/Del./2013)

TPO is to conduct a Transfer Pricing analysis to determine Arm's Length Price (ALP) and not to determine whether there is a service from which assesse derived benefit or not.

Facts of the case:

The assessee is a company engaged in manufacturing, sale and service of two wheelers, parts and accessories thereof. The assessee is a wholly owned subsidiary of M/s. Honda Motors Company Ltd., Japan. The assessee had reported ten international transactions. But the TPO accepted only eight transactions at Arm's Length Price (ALP). The international transaction was related to payment of 'export commission', for which the TPO held that no services were rendered by the Associated Enterprise to deserve the export commission and determined the ALP as "nil".

As regards international transaction of payment of "royalty", the TPO disputed the payment of royalty in respect of exports made to AE's. He opined that since assessee is making a part of its sales to its related parties and benefit of producing components is reaped by the AE, the payment of royalty did not conform to the arm's length principle. He, therefore, made the TP adjustment amounting to Rs.1,22,06,657/- in respect of payment of royalty for exports to AEs.

The aggrieved assesse filled an appeal before Disputes Resolution Panel (DRP), but the assessee's plea was rejected and confirmed the

assessment order as passed by the A.O. Assailing the said order passed by DRP, the assesse filed an appeal before the Tribunal.

Decision of the Tribunal:

The Hon'ble Tribunal held as under:

- In regards to export commission, relying on the judgment of the Hon'ble Jurisdictional High Court in case of **CIT-I Vs. Cushman and Wakefield (India) (P.) Ltd. [2014] 46 taxmann.com 317 (Delhi)**, the Hon'ble Tribunal has held that necessarily AO has to determine whether the assessee has derived any benefit from payment of export commission and if any benefit had derived, whether such payment is commensurate to comparable transaction has to be examined by the TPO. For this purpose, the issue is restored to A.O/TPO for de novo consideration.

- As regards to payment of royalty fees, the Hon'ble Tribunal, relying on the case of sister concern, M/s. Hero MotoCorp Ltd. (ITA No.5130/Del/2010.) which was based on the same facts and also relying on the payment agreement, it was held that the assessee is liable to pay the royalty of the goods manufactured whether the same is sold in India or outside India. There is no justification on record for disallowance of royalty payment on the export made to the AEs.

Thus, the Tribunal has deleted the addition made by the AO/TPO by determining the ALP at 'NIL' for royalty and export commission paid to the AE.

c. <u>Birlasoft (India) Limited Vs. DCIT (ITA No. 200/Del/2015)</u>

Internal benchmarking analysis could be used to determine the ALP for International Transactions with AEs if

transactions with unrelated parties undertaken in similar functional and economic scenario

Facts of the case:

The A.O. made adjustment of Rs. 30,08,43,288 to the income of the assessee on account of the alleged difference in the arm's length price of the international transactions undertaken during the previous year on the basis of order passed by Transfer pricing Officer ('TPO') under section 92CA(3) of the Act.

The Dispute Resolution Panel ('DRP')/TPO disregarded the internal benchmarking undertaken by the assesse for determining the arm's length price of the international transactions applying TNMM.

The assessee contended that the internal benchmarking undertaken by the company was disregarded without pointing out any error or mistake in the profitability summary in relation to revenue earned from AE and non AEs transaction worked out by the assessee and also certified by independent Chartered Accountants.

Assailing the said order passed by DRP, the assesse filed an appeal before the Tribunal.

Decision of the Hon'ble Tribunal:

A co-ordinate Bench of this Tribunal in assessee's own case for the Assessment Year 2006-07 had held that the assessee was justified in undertaking internal bench marking analysis on standalone basis by placing on record working of operating profit margin from International Transactions with AEs and transactions with unrelated parties undertaken in similar functional and economic scenario, and the same should be the basis for determination of Arm's Length Price in respect of International Transactions undertaken with the associated enterprise. Further, this Tribunal had also directed the Assessing Officer / Transfer Pricing Officer

to determine Arm's Length Price of International Transactions with AEs by making internal comparison of the net margin earned by the assessee from the international transaction with associated enterprises and the profit earned by the assessee from the international transactions with unrelated parties.

Since the facts for the year under consideration are identical to the facts involved in the aforesaid Assessment Year 2009-10 in assessee's own case, the Hon'ble Tribunal keeping in view the dictum laid down by a co-ordinate Bench of this Tribunal in assessee's own case set aside the addition made by AO with a direction to the AO/TPO to decided the case as directed in Tribunal order for Assessment Year 2009-10.

2. Domestic Taxation case laws:

a. Heranba Industries Limited. Vs. DCIT (ITA No.2292/Mum/2013) Initiation of penalty proceedings stipulate collection of evidence to prove deliberate mistake of the assesse; mere voluntary surrender of income by the assessee cannot be the basis for levying penalty u/s 271(1)(c) of the Act.

Facts of the case:

The assessee is engaged in manufacturing of pesticides, herbicides and formulations. The Assessing officer (AO) found that the assessee had received share application money of Rs.89.50 lakhs during the year under consideration. The assessee was asked to furnish the details with supporting evidences. Unable to do so, the assessee voluntarily offered the said income for tax.

The AO, not being satisfied with the explanation of assessee, levied penalty on the same income. The assessee appealed to the Commissioner of Income tax (Appeals), wherein CIT(A) upheld the order of AO. Aggrieved by the order of CIT(A), assessee filed an appeal before the Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal while giving relief to assessee held as under:

- At the very first instance, share application money was surrendered by assessee with a request to not initiate any penalty proceedings;
- There was no malafide intention on the part of the assessee and the AO had not brought any additional evidence on record to prove that there was concealment of income;
- The Hon'ble Tribunal relying on the judgement of Hon'ble Supreme Court in case of **CIT Vs. Suresh Chandra Mittal (251 ITR 9) (SC)**has held that if the assessee has offered the additional income to buy peace of mind and to avoid litigation, penalty u/s 271(1)(c) of the Act cannot be levied.

Thus, when there is no evidence on record to prove the deliberate concealment on part of the Assessee, the AO can't levy penalty on the addition made due to voluntary surrender of income by the assesse.

2. Hirachand Kanuga Vs. DCIT (ITA Nos. 4261 & 4262 /Mum/ 2012)

Where Commissioner simply put 'approved' and signed report thereby giving sanction to Assessing Officer to reopen assessment, it did not amount to recording of proper satisfaction in terms of section 151(1) of the Act

Facts of the case:

The assessee filed his return declaring certain taxable income. The Assessing Officer completed assessment making certain addition to assessee's income. Subsequently, a search was carried out in the case of M/s. Mahanagar Securities Pvt. Ltd. and its group concern in course of which it was found that said company was engaged in fraudulent billing activities and in the business of providing bogus speculation profit/loss. The list of persons seeking entries for bogus profits/loss included name of assessee along with his minor daughters and son.

On basis of said information, the Assessing Officer reopened the assessment. Thereupon, the Assessing Officer proceeded to complete the assessment by treating the entire sale consideration of shares as 'income from Other Sources'. The Commissioner (Appeals) confirmed the order passed by the Assessing Officer.

Aggrieved by the order of CIT(A), assessee filed an appeal before the Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal while giving relief to assessee held as under:

- Sections 147 and 148 are charter to the revenue to open earlier assessments and are, therefore protected by safeguards against unnecessary harassment of the assessee. They are sword for the revenue and shield for the assessee. Section 151 guards that the sword of section 147 may not be used unless a superior officer is satisfied that the Assessing Officer has good and adequate reasons to invoke the provisions of section 147. The superior authority has to examine the reasons, material on grounds and to judge whether they are sufficient and adequate to the formation of the necessary belief on the part of the Assessing Officer.
- If, after applying his mind and also recording his reasons, howsoever briefly, the Commissioner is of the opinion that the Assessing Officer's belief is well reasoned and bona fide, he is to accord his sanction to the issue of notice under section 148.
- In the instant case, the Commissioner has simply put 'approved' and signed the report thereby giving sanction to the Assessing Officer. Nowhere the Commissioner has recorded a satisfaction note, not even in brief.

Therefore, it cannot be said that the Commissioner has accorded sanction after applying his mind and after recording his satisfaction. Thus, it is held that the reopening proceedings is bad in law and the assessment has been held as void ab initio.

3. Mysore Intercontinental Hotels Ltd. Vs. ACIT (ITA No. 727 of 2009-Karnataka High court)

Facilities given by assessee along with let out buildings/commercial establishments were inseparable and

entire construction and interiors of buildings was done with sole intention of carrying on business, entire income would be assessed as 'business income'.

Facts of the Case:

The assessee-company, carried on the business of establishing facilities as are available in an information technology park. It provided facility to IT industry and similar commercial facilities by letting out hotels, commercial complexes in an integrated manner, so that user from whom the assessee derived income could walk in and plug in and commence business operations straight away without doing anything more.

The assessee claimed rental income derived from tenants as 'business income'. The assessing officer treated 80 per cent of assessee's income as 'income from house property' and 20 per cent of income as 'income from other sources'.

However, the appellate authority treated 60 per cent of the rental income as 'business income' and 40 per cent of the income as 'income from house property'. The Tribunal affirmed the order of the Commissioner (Appeals). Aggrieved by the decision of the Tribunal, the assesse filed an appeal before the Hon'ble High Court.

Decision of the Hon'ble High court:

The Hon'ble High Court held as under:

- In this case what is to be seen is; firstly, what is the intention behind the lease and secondly, what are the facilities given along with the buildings and documents executed in respect of each of them and thirdly, it is to be found out, whether it is inseparable or not. If they are inseparable and the intention is to carry on the business of letting out the commercial property and carrying on complex commercial activity and getting rental income therefrom, then such a rental income falls under the head of profits and gains of business or profession.

- It is clear that the entire construction and the interiors are all done with the sole intention of carrying on the business and, therefore, the claimant is entitled to treat the entire income as income from business.

Thus, the authorities were not justified in bifurcating the income into the rental income and the business income.

4. Kirti Dahyabhai Patel Vs. ACIT (ITA No. 1181 of 2010-Gujart High Court)

Section 271(1) of the Act does not specify any time limit during which the amount of penalty with interest has to be paid and immunity available under this section can be granted.

Facts of the Case:

The assessee had filed its return of income for the Assessment Year 2002-03 on 07.06.2002, declaring total income at Rs. 1,30,900/. A search u/s 132 of the Act was conducted in the assessee's residential and office premises on 04.09.2003. In response to the notice u/s 153(1)(a) of the Act, the assessee disclosed additional income over and above the income which was declared in the original return. The assessee paid the entire additional amount with interest. Simultaneously, penalty proceedings were also initiated under Section 271(1)(c) of the Act as the assessee disclosed additional income in pursuance of the search. However, the A.O rejected the contention of the assesse and levied penalty @ 100% of the tax sought to be evaded.

The assessee filed an appeal before the CIT(A). CIT(A) deleted the said penalty imposed by the AO. Aggrieved by this decision, the revenue filled an appeal before ITAT. However, as there was difference in opinion between the two members, the matter was then referred to the third member which contended in favour of the revenue. Aggrieved by the decision of the Tribunal, the assesse filed an appeal before the Hon'ble High Court.

Decision of the Hon'ble High court:

The Hon'ble High court, relying on the decision of Hon'ble Madras High Court in the case of S.D.V. Chandru (2004) 266 ITR 175 (Mad), held that the assessee had satisfied all the conditions which were required for claiming immunity from payment of penalty u/s 271(1) of the Act.

Also, the provision does not specify any time limit during which the amount of penalty with interest has to be paid. Admittedly, as the assessee had paid the entire amount with interest, the A.O

ought to have granted them immunity available u/s 271(1)(c) of the Act.

Thus, the Hon'ble High Court has deleted the penalty levied by the AO and granted immunity from penalty.