Print

MARCH, 2015

DIRECT TAX UPDATE

SUMMARY OF JUDGEMENTS

Transfer pricing and International taxation issues

- Eaton Fluid Power Limited Vs. CIT (IT Appeal No. 1623/PN/2011)

ITAT deletes the TP adjustment, supporting assessee's Internal TNMM carried out on the basis of functional similarity rather than product similarity as essential for applying TNMM.

- Anglo-Eastern Ship Management (India) Private Ltd Vs. DCIT (IT Appeal No. 1824/M/2014)

Issue of shares at a premium by assessee to its AE did not give rise to any "income" from an International Transaction. Hence, relying on jurisdictional HC ruling in Vodafone India Services (P) Ltd vs Union of India ITAT held that adjustment made by TPO were outside the scope of TP provisions.

- Micromax Informatics Ltd Vs. DCIT (IT Appeal No. 6135/Del/2014)

ITAT held that for correct benchmarking in loan transaction interest rate to be applied is the interest rate of the currency in which the amount has been advanced. For the issue of standby letter of credit the rate charged by the assessee of 1% was accepted.

Domestic issues

KNAV is a firm of International Accountants, Tax and Business Advisors.

Presence in|
INDIA
USA
UK
FRANCE
NETHERLANDS
SWITZERLAND
CANADA

E: admin@knavcpa.com
W: www.knavcpa.com

- Ziauddin Ahmad (IT Appeal Nos. 467 & 242 of 2010 High court of Allahabad)

Where assessee had transferred possession of land and all other rights except title at time of entering into an agreement with a builder, capital gain would not be levied in relevant assessment year in which title of land was transferred.

- Kul Foundation Vs. CIT (IT Appeal No. 1692 of 2013 Pune-Tribunal)

Provisions of section 13 couldn't be applied to deny registration to a trust or an Institution under section 12A. It shall be applied to decide deduction to be allowable to a trust or an Institution while completing assessment proceedings.

- Srei Infrastructure Private Limited Vs. ACIT (IT APPEAL NOS. 371 & 372 OF 2012 High Court of Delhi)

Creation of statutory reserve under any statute are to be treated alike and in a similar manner as other reserves. It is to be include in computation of book profits under section 115JB of the Income-tax Act, 1961.

Circular

- Circular no. 2/2015 dated 10.02.2015

No interest to be charged under section 234A of the Act on the self-assessment tax paid before due date of filing return of income.

1. Transfer pricing and International taxation issues

a. Eaton Fluid Power Limited Vs. CIT (IT Appeal No. 1623/PN/2011)

ITAT deletes the TP adjustment, supporting assessee's Internal TNMM carried out on the basis of functional similarity rather than product similarity as essential for applying TNMM.

Facts of the case:

The assessee is engaged in the business of manufacturing and distribution of hydraulic components and packaged systems. It had entered into certain international transaction with its AE and aggregated the transactions in manufacturing and trading segment in order to apply TNMM as most appropriate method with operating profit to operating revenue as the PLI (Profit Level Indicator).

As per TPO, separate benchmarking was required to be undertaken for manufacturing as well as trading segment. Whilst ignoring assessee's plea of considering internal comparables (within the manufacturing segment) in preference to the external comparables an adjustment was made to transactions of the manufacturing segment.

The departmental representative opined that the benchmarking analysis done by the assessee didn't give the correct picture and also the transactions with the third parties used for the comparability are not purely identical with the transactions entered with the AE.

Decision of the ITAT:

The Tribunal asserted with the assessee's argument that the spilt of the manufacturing segment into AE and Non AE segment was done on the basis of manufacturing of products which requires raw material imported from AE and products which do not require raw material imported from AE and considered it as fair and apt. Also, that there was a functional similarity rather than perfect product similarity which was essential for application of TNMM and hence, internal TNMM comparables used by the assessee was wrongly rejected by the TPO.

Hence, the international transactions entered with the AE under the Manufacturing segment on account of purchase of raw material and components and also sales were held consistent with the arm's length price and the transfer pricing adjustment made by the TPO was deleted.

b. Anglo-Eastern Ship Management (India) Private Ltd Vs. DCIT (IT Appeal No. 1824/M/2014)

Issue of shares at a premium by assessee to its AE did not give

rise to any "income" from an International Transaction. Hence, relying on jurisdictional HC ruling in Vodafone India Services (P) Ltd vs Union of India, the Hon'ble ITAT held that adjustment made by TPO were outside the scope of TP provisions.

Facts of the case:

The assessee is engaged in the business of ship management and other related services. assessee had an international transaction with the AE in connection with the issue of 25000 equity shares to the AE at a premium of Rs. 790/- per share. TPO ascertained the ALP of the share at Rs.9,163 per share and accordingly made TP addition.

The aforementioned addition was confirmed by DRP. The issue that arose for consideration before the Tribunal was:

Whether considerable substance exists in the assessee's case that neither the capital receipts were received by the assessee on issue of equity shares to its holding company, a non-resident entity, nor there was an alleged short-fall between the so called fair market price of its equity shares. Also, whether the issue price of the equity shares could be considered as income within the meaning of the expression as defined under the Act.

The Hon'ble Tribunal held in favour of the assessee by relying on the MSC Crewing Services (P) Ltd and Hon'ble HC ruling in Vodafone India Services (P) Ltd as under:

- A plain reading of section 92(1) of the Income-tax Act,1961 (the Act) pronounce that "income" arising from an International Transaction was a condition precedent for application of Chapter X of the Act;
- Transfer Pricing provisions were to ensure that in case of International Transaction between AEs, neither the profits were understated, nor losses overstated. They did not replace the concept of Income or Expenditure as normally understood in the Act, for the purposes of transfer pricing provisions;
- The issue of shares at a premium was a capital account transaction and not income;

- Also, the amount received on issue of shares was a capital account transaction not separately brought within the definition of Income, except in cases of premium received from resident in excess of the fair market value of the shares.

c.Micromax Informatics Ltd Vs. DCIT (IT Appeal No. 6135/Del/2014)

The Hon'ble ITAT held that for correct benchmarking in loan transaction interest rate to be applied is the interest rate of the of the currency in which the amount has been advanced. For the issue of standby letter of credit, the rate charged by the assessee of 1% was accepted.

Facts of the case:

The assessee company is the 12th largest handset manufacturer in the world (according to Global Handset Vendor Market Strategy Analytics) share report from with presence across India and globally. The assessee had advanced loan to its AE in Dubai in US dollars and on which it has charged interest at the rate of 9.25%.

The TPO was of the view that the average yield of the long term instrument is 11.91% and SBI prime lending rate is 12.625% and the net profit before tax, the average return in the case of the assessee comes to 12.51% and taking average of these three and adding further 300 basis point he computed the rate of interest at 15.35%.

The assessee had selected a CUP as the Most Appropriate Method for ascertaining the ALP and contended that the domestic prime lending would have no applicability in the said transaction and the international rate fixed being LIBOR would come into play as it is the mostly used and recognised benchmark rate for international loan.

Secondly, the assessee has issued Standby Letter of Credit to its AE and charged a fee at the rate of 1% at cost from its AE. However TPO was of the view that normal rate charged by the bank for issuing such Standby Letter of Credit was 1 to 2.25% and hence, directed a rate of 2% to be applied and accordingly made additions thereof.

The assessee contended that it has obtained Standby Letter of Credit

by paying 1% cost and that the rate of 2% would mean 100% Profit on the cost incurred by the assessee in obtaining the Standby Letter of Credit.

Decision of ITAT:

- The Hon'ble ITAT concurred with the assessee's contention that where the transaction was of lending money in foreign currency to its foreign subsidiaries the comparable transactions, therefore, was of foreign currency lended by unrelated parties. And that the financial position and credit rating of the subsidiaries will be broadly the same as the holding company. In such a situation, domestic prime lending rate would have no applicability and the international rate fixed being LIBOR should be taken as the benchmark rate for international transactions.
- The Hon'ble ITAT held that the rate of 2% was not justified and 1% of stand by letter of credit amount was taken as arm's length price.

2. Domestic Taxation

a. CIT Vs. Ziauddin Ahmad (IT Appeal Nos. 467 & 242 of 2010 High court of Allahabad)

Where assessee had transferred possession of land and all other rights except title at time of entering into an agreement with a builder, capital gain would not be levied in relevant assessment year in which title of land was transferred

Facts of the case:

The assessee had entered into an agreement on 24-6-1999 with a builder for development of his land and after obtaining the sanctioned map, the parties entered into supplementary agreement in which assessee handed over possession of the land except title to the said builder. In the relevant assessment year, on completion of project assessee handed over title of land to the builder.
The Assessing Officer held that since title of land was handed over in relevant assessment year, assessee was liable to pay capital gain in relevant assessment year only. On appeal, the Commissioner (Appeals)

upheld the order of the Assessing Officer.
On further appeal, the Tribunal granted the relief by observing that capital gain by holding that capital gain would not be chargeable in relevant assessment year.

Assailing the said order passed by Tribunal, the revenue filed an appeal in the High court.

Decision of the High Court:

The Hon'ble High Court held as under:

- The Tribunal in its impugned order has observed that as per terms and conditions of the agreement dated 24-6-1999 the transfer was effective from that very day and not in the year of 2005 as wrongly observed by the Assessing Officer. The capital gain is applicable in the year when the possession was handed over by the assessee. In the instant case, the assessee's all other rights, except title, stood transferred and therefore, the capital gain was to be computed on the basis of transfer and in the year of the transfer. It is evident in the instant case that the partial possession was given in the year 1999. The title was transferred on 30-4-2005, so no capital gain could have been accrued on 30-4-2005 for the assessment year 2006-07, as wrongly claimed by the revenue.

- In view of the above, the transfer of the land under reference did not take place on 30-4-2005 as claimed by the Assessing Officer or arose during the assessment year 2006-07. Hence, there is no reason to interfere with the order passed by the Tribunal.

Therefore, the capital gain is applicable in the year when possession of land was handed over by the assesse and not in the year of transfer of title of land.

b. Kul Foundation Vs. CIT (IT Appeal No. 1692 of 2013 (Pune-Tribunal))

Provisions of section 13 couldn't be applied to deny registration to a trust or an Institution under section 12A. It shall be applied to decide deduction to be allowable to a trust or an Institution while completing assessment proceedings.

Facts of the case:

In the instant case, one of the objects of the trust was limited to the benefit of Jain community;
Since benefits of sections 11 and 12 could not be extended to the charitable trust or institution which was established for the benefit of any specific religious community, the CIT contended that trust had violated provisions of section 13(1)(b). Hence, he denied registration to trust under section 12A.

The issue that arose for consideration before the Tribunal was:
Whether the CIT has erred in denying the trust registration under Section 12A holding that the object clause of the Trust Deed is specifically for the benefit of the Jain Community which is a specific religious community and hence attracts the provisions of sec.13(1)(b)?

Decision of the Tribunal:

The Tribunal held in favour of assessee as under:

- In order to avail of the deduction under sections 11 and 12 of the Act, the trust or institution has to make an application for registration under section 12AA of the Act;
- The CIT after satisfying himself about the objects of the trust or Institution and about the genuineness of its activities, had to pass an order in writing granting or refusing the registration;
- The Assessing Officer had to consider non-fulfillment of the conditions laid down in section 13(1)(b) during assessment procedure while allowing deduction under sections 11 and 12 to the trust or Institution.

Therefore, the CIT was not authorized to consider violation by the trust or Institution on account of provisions of section 13(1)(b) while granting it registration under section 12A.

c. Srei Infrastructure Private Limited Vs. ACIT (IT APPEAL NOS. 371 & 372 OF 2012 HIGH COURT OF DELHI)

Creation of statutory reserve under any statute are to be treated alike and in a similar manner as other reserves. It is to be include in computation of book profits under section 115JB of

the Income-tax Act, 1961 (the "Act").

Facts of the case:

The assessee was indulged in the business of leasing of commercial vehicles, infrastructure construction machinery/equipment and financing of infrastructure projects equipment/machinery. For the assessment year 2007-08, the assessee had declared a return declaring book profit of INR 475,442,043. In the assessment order, given by the Assessing Office (AO), book profit under section 115JB of the Act was increased by INR 16 Crores which represented special reserve created under section 45-IC of the Reserve Bank of India Act, 1934 (the "other Act").

The assessee appealed to the Commissioner of Income-tax (CIT) who upheld the order of the AO. Subsequent to which assessee preferred appeal at the Tribunal, wherein the tribunal upheld the order of CIT.

Aggrieved, the assessee is in appeal at the Hon'ble High Court.

Decision of High Court:

The Hon'ble High Court held in favour of revenue as under:

- The legislature in express, lucid and categorical terms has stipulated that the book profit shall be increased by the amounts carried to any reserve. The word "any" refers to all kinds of reserves and encompasses all types and categories without exception. The legislature did not stop and has thereafter used the expression "reserve by whatever name called". The intention is unambiguous, i.e. book profit would include all amounts carried to any reserve by whatever name called, except the reserve specified under section 33AC of the Act.

- Relying on the principles laid down by the Hon'ble Supreme Court in case of *Associated Power Co. Ltd* v. *CIT* [1996] 218 ITR 195 high court held that the reserve, which is required to be created under Section 45-IC, is out of the profits earned by a non-banking financial institution. It is not an amount diverted at source by overriding title.

It was only appropriation of profits after they had been earned. It is not an expense.

Thus, reserves created is to be included in the computation of book profit u/s 115JB.

3. Circular

Circular no. 2/2015 dated 10.02.2015

Interest under section 234A of the Act is charged in case of late filing of return of income by the assessee. The interest is charged at a rate 1 % per month on total amount of tax payable reduced by advance tax, TDS , relief under section 90 & 91 and MAT tax credit allowed under the Act. Since, self-assessment tax is not mentioned as a component for reduction, interest on the same was charged even if it was paid before due date of filing return of income.

The Hon'ble Supreme Court in the case of *CIT Vs. Prannoy Roy, 309 ITR 231*, held that no interest would be payable in a case where tax has been deposited prior to due date of filing of income-tax return.

The CBDT has accordingly reviewed its present practice of levying interest under section 234A on the self-assessment tax paid by the assesse before due date of filing return of income. The CBDT vide **Circular no. 2/2015 dated February 10, 2015** decided that *"no interest under section 234A of the Act is chargeable on the amount of self-assessment tax paid by the assesse before due date of filing return of income"*

KNAV Comments: This circular will enable all assessee to claim refund of already paid interest under section 234A of the Act on the amount of self-assessment tax paid before due date of filing return of income. Also, in future it will avoid needless litigation relating to interest under section 234A of the Act.

apply.