November, 2014

DIRECT TAX UPDATE

1. Transfer Pricing

a. GECF Asia Ltd Vs. Deputy Director of Income-tax, International Taxation - 3(1) [IT Appeal No. 8922 (Mum.) of 2010]

If services relating to industrial, commercial or scientific experience do not involve imparting of know-how or transfer of any knowledge, experience or skill, then payment received in respect of same cannot be taxed as "royalty" within the ambit of article 12 of India-Thailand DTAA

Facts of the Case:

The assessee company was incorporated in Thailand. It was engaged in the business of providing services to meet the needs of various G.E. Group companies. During the relevant year, assessee provided various business support services to a group company in India namely GEMFSL.

During the course of the assessment proceedings, the AO held that amount received by assessee for rendering various services to an Indian company would fall within the definition of 'royalty' under Article 12(3) of India-Thailand DTAA and, hence, would be taxable in India. The DRP confirmed order

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passed by the Assessing Officer / TPO.

The assessee filed an appeal before the Tribunal wherein the ITAT held that in absence of a Permanent Establishment in India, any receipt wouldn't be taxed in India by virtue of Article 5 r.w. Article 7 of the Indo-Thailand DTAA and hence the only issue which was in dispute was whether the payment received by the assessee in lieu of services rendered to GEMFSL is taxable as *"royalty"* under Article 12(3) or not?

Decision of the Tribunal:

In this regard, the Hon'ble ITAT held as under:

- The royalty payment received as consideration for information concerning industrial, commercial, scientific experience alludes to the concept of know-how. There is an element of imparting of know-how to the other, so that the other person can use or has right to use such know-how;

- In case of industrial, commercial and scientific experience, if services are being rendered simply as an advisory or consultancy, then it cannot be termed as *"royalty"*, because the advisor or consultant is not imparting his skill or experience to other, but rendering his services from his own know-how and experience. All that he imparts is a conclusion or solution that draws from his own experience.

- The thin line distinction which is to be taken into consideration while rendering the services on account of information concerning industrial, commercial and scientific experience is, whether there is any imparting of

know-how or not. If there is no *"alienation"* or the*"use of"* or the "right to use of" any know-how i.e., there is no imparting or transfer of any knowledge, experience or skill or know-how, then it cannot be termed as *"royalty"*.

- The services may have been rendered by a person from own knowledge and experience but such a knowledge and experience has not been imparted to the other person as the person retains the experience and knowledge or know-how with himself, which are required to perform the services to its clients. Hence, in such a case, it cannot be held that such services are in nature of *"royalty"*.

Thus, if services have been rendered and those services do not involve imparting of know-how or transfer of any knowledge, experience or skill, then it cannot be held to be taxable as royalty.

b. Prysmian Cavi e Sistemi SRL Vs. ACIT, Circle-2 (3) [IT Appeal Nos. 916 (Hyd.) of 2006 and 244 & 246 (Hyd.) of 2012]

Where offshore contract was only for procurement of cables that too outside India, no part of income could be said to be attributable to assessee's PE in India

Facts of the Case:

The assessee, an Italian company, entered into three different contracts with Power Grid Corporation of India Limited (PGCI) for setting up a Fiber Optic system for Southern Region and obtained requisite permission from RBI for execution of onshore supply contract and onshore services contract with PGCI.

The assessee offered income only from two contracts relating

to onshore supplies and onshore services contract while maintaining that the income from offshore contract was not taxable in India.

The Commissioner issued a Show Cause Notice as to why the receipts arising from the off-shore contracts should not be brought to tax.

After considering the detailed submissions of the assessee and analyzing the terms of agreement, the Commissioner held that the income, as was reasonably attributable to the operations carried out in India relatable to the offshore contract, was liable to tax in India. The Assessing Officer was directed to ascertain the actual income which was taxable in India on the offshore contract receipts in accordance with law by resorting to the provisions of Rule 10 of the Income Tax Rules, if necessary.

The assessee filed an appeal before the Tribunal.

Decision of the Tribunal:

The Hon'ble Tribunal Held as under

- The issue of taxability of off shore contracts was elaborately discussed in the earlier Assessment Year 2000-01 in Pirelli Cavi e Sistemi Telecom S.P.A. v. Asstt. CIT ***[2014] 46 taxmann.com 216 (Hyderabad - Trib.)*** vide order dated 28-5-2014 wherein similar issue was raised by the Assessing Officer consequent to the orders under section 263 by the Commissioner in this year. The Tribunal considered the issue elaborately and decided in favour of the assessee, holding that since offshore contract was only for procurement of cables that too outside India, no part of income could be said to be attributable to

assessee's PE in India and hence the impugned addition deserved to be set aside.

- Respectfully following the above, since this year is later to the issue already decided as above, the principles laid down therein are equally applicable to the appeal in the impugned assessment year 2001-02. Accordingly, the contention of the assessee was allowed and order of the Commissioner was set aside.

- In fact, the Commissioner passed her findings purely on the basis of the judgment of Authority for Advanced Rulings in the case of *Ishikawajima Harima Heavy Industries Co. Ltd.* ***[2004] 271 ITR 193/141 Taxman 669 (AAR-New Delhi)*** which was reversed by the Supreme Court. In view of that also, the order of the Commissioner cannot be sustained.

Thus, the assessee's grounds are allowed.

2. Domestic Taxation

a. CIT Vs. SRIRAM INDUBAL (T.C. (A) Nos. 419 and 533 of 2014-Madras High Court

The assessee is eligible for a deduction of Rs. 1 Crore under section 54EC of the Income tax Act, 1961 in respect to investment of Rs. 50 lakhs made in two different financial years.

Facts of the Case:

The assessee sold a property at Palavakkam for a sale consideration of Rs.3,46,50,000/- vide agreement of sale dated 18.2.2008. He invested Rs.1,00,00,000/- out of the sale proceeds in certain bonds in two financial years, namely,

Rs.50,00,000/- in Rural Electrification Corporation Bonds in the Financial Year 2007-2008 and Rs.50,00,000/- in National Highways HAI Bond in the Financial Year 2008-2009.

The Assessing Officer held that the assessee can take the benefit of investment in specified bonds to a maximum of Rs. 50,00,000/- only u/s 54EC(1) of the Act and accordingly, held that the other sum Rs. 50,00,000/- invested over and above the ceiling prescribed does not qualify for exemption in terms of the Act.

The assessee filed an appeal to CIT(A), who confirmed the order of the Assessing Officer in this regard. The assessee preferred appeal to the Tribunal. The Tribunal held that the exemption granted under proviso to Section 54EC(1) of the Act should be construed not transaction-wise, but financial year-wise. It further held that if an assessee is able to invest a sum of Rs.50,00,000/- each in two different financial years, within a period of six months from the date of transfer of the capital asset, it cannot be said to be inadmissible.

Assailing the said order passed by the Tribunal, the department filed an appeal in the high court.

Issue before the High Court:

Whether the assessee is eligible for deduction of Rs. 1 Crore under Section 54EC of the Act in respect of investment of Rs. 50 Lakhs made in two different financial year but with the six months period from date of transfer of capital asset?

Decision of the High Court:

The Hon'ble High Court while giving relief to the assessee held as under

- On reading of the section 54EC of the Act, the said section restricts the time limit for the period of investment after the property has been sold to six months. There is no cap on the investment to be made in bonds.

- The first proviso to Section 54EC(1) of the Act specifies the quantum of investment and it states that the investment so made on or after 1.4.2007 in the long-term specified asset by an assessee ***during any financial year does not exceed fifty lakh rupees***. In other words, as per the mandate of Section 54EC(1) of the Act, the time limit for investment is six months and the benefit that flows from the first proviso is that if the assessee makes the investment of Rs.50,00,000/- in any financial year, it would have the benefit of Section 54EC(1) of the Act.

Therefore, it is held that time limit for investment is six months from the date of transfer and the benefit claimed by the assessee cannot be denied even if such investment of Rs. 1 Crore falls under two financial years.

b. CIT Vs. Smt. V. R. Karpagam (Tax Case (Appeal) No.301 of 2014-HC of Madras)

For exemption u/s 54F, the term "a residential property" is interpreted in plural connotation for the purpose of reinvestment of capital gain.

Facts of the case:

The assessee had entered into an agreement for development of a piece of land measuring 13,059 sq.ft. owned by her. As per the agreement, the assessee was to receive 43.75% of the built up area after the development. This 43.75% built up area was translated into five flats. The assessee, while filing her return of income, calculated the capital gains based on the sale

consideration of Rs.1,09,75,620/-. The assessee claimed exemption u/s 54F of the Income Tax Act on the value of the five flats.

The Assessing Officer granted the benefit of capital gains in respect of one flat and that too on the higher extent with regard to the floor space, viz., 2413.36 sq.ft. The Commissioner of Income Tax upheld the decision but, the benefit of section 54F was given in respect of one single flat with the largest area of 4814.36csq.ft. The Tribunal, by considering the provision of Section 54F of the Income Tax, Act and taking note of the decision of the Hon'ble Karnataka High Court in the case of ***CIT V. Smt. G. Rukminiamma (331 ITR 211)***, which referred to Section 13 of the General Clauses Act, held that the word 'a' appearing in Section 54F of the Income Tax Act should not be construed in singular, but should be understood in plural. The tribunal gave the decision in the favour of the assessee.

Revenue filed an appeal before the High Court.

Issues before the High court

1. Whether the Tribunal was justified in treating five independent flats in a multi-storey construction as a single residential unit under Section 54F, without considering the intention of the legislature to restrict the reinvestment to only one more residential unit under Section 54F?

2. Whether the Tribunal was right in interpreting the phrase "a residential house" in plural connotation for the purpose of reinvestment of capital gain for claiming exemption under Section 54F?"

Decision of the High Court:

The Hon'ble High Court while giving relief to the assessee held as under-

- The transaction in this case was not with regard to the number of flats but with regard to the percentage of the built up area, vis-a-vis, the undivided share of land.

- The Court has referred to its own decision order dated 04.01.2012 in ***T.C.(A)No.656 of 2005*** wherein it has held that even if there are four different flats and if it is considered for the property assessed as one unit and one door number is given, it should be construed as a residential unit, namely, one unit.

Thus, the Court granted the benefit to the assessee u/s 54F of the Income Tax Act on the investment made in five flats.

c. Omniglobe Information Tech India Pvt Ltd Vs. CIT (Income Tax Appeal 257/2012-High Court of Delhi)

Recruitment of employees and providing training and up-gradation of skills of employees in service industry (BPO) held as business has been setup

Facts of the Case:

The assessee was incorporated on 19th March, 2004, as a subsidiary of one M/s Omniglobe International, USA, as a business process service provider. The assessee had claimed deduction under section 10B, of the Income Tax Act, 1961 for a period commencing from 1.4.2004 to 31.5.2004, contending that it had obtained approval as a 100% Export Oriented Unit

under STPI scheme and had commenced operations from 1.4.2004.

The assessee was in the business of voice activation and local number portability, i.e. Business Process Outsourcing (BPO) services, which were made available to M/s Omniglobe International, USA. The assessee had placed on record, before the Commissioner of Income Tax (Appeals), a copy of the agreement dated 30th March, 2004, between M/s Agilis Information Technologies International Pvt. Ltd ("M/s Agilis") and the assessee company. Under the said agreement, the assessee was entitled to use to use the premises taken on lease by M/s Agilis, during 20:00 hrs to 08:00 hrs. It stipulated that the assessee was entitled to use personal computers of M/s Agilis or install their new personal computers in the premises, but upon termination of the agreement, personal computers belonging to the assessee would be removed.

The Assessing Officer as well as the Tribunal have held that the appellant assessee had commenced its operations only from 1.6.2004, i.e. the date on which the appellant assessee entered into "service agreement" with its parent company and, therefore, the expenditure incurred between 1.4.2004 to 31.5.2004 should be capitalized.

The Hon'ble Tribunal, in its impugned order had also observed that the appellant assessee had entered into a lease agreement and had hired premises as its office, only on 15.6.2005. Commissioner of Income Tax (Appeals), however, had decided the issue / question in favour of the respondent assessee.

The assessee filed an appeal before the High Court.

Decision of the High Court:

The Hon'ble High Court held as under-

- Upon recruitment of employees, the factum that expenditure under the different heads was incurred is indicative that business was set up;

- Training to the employees was given to ensure that when the work was undertaken and performed, there were no glitches, trouble or problems. It is not indicative of the fact that necessary infrastructure was not there and actual business could not have commenced or was not set up. Training was post set up as the employees were recruited.

- In service industry, training and up gradation of skills of employees is a part and parcel of the business activity, a continuous process. The business as a service provider, cannot exist without the said activity being undertaken both at the very initial stage and after business has commenced.

Therefore, the moment the training and up-gradation of skills of employees commenced, the business had been setup.

d. Muthoot Finance Ltd. Vs. ACIT (Income Tax Appeal 24 & 154 of 2014 (TCoch)

Where assessee had not claimed payment made to non-resident for providing engineering site services as expenditure but capitalized the same and claimed only depreciation thereon, no disallowance could be made under section 40(a)(i)

Facts of the Case:

The assessee was a NBFC engaged itself in providing gold loan and other allied investment activities. It made payment to non-resident for providing engineering site services but did not deduct tax at the time of payment.

The AO disallowed the entire payment made by the assessee as provided in section 40(a)(ia) on account of non-deduction of tax at source.

The assessee submitted that it had not claimed any expense on account of the payment made to non-resident but had capitalized the same and subsequently claimed depreciation. The assessee submitted that the disallowance could be considered only in case the assessee claimed deduction while computing the income chargeable to tax but it had not claimed any deduction. The disallowance was made by the lower authority u/s 40(a)(ia) and section 40(a)(i) was not taken into consideration. On appeal, the Commissioner (Appeals) upheld the order of the AO.

Assailing the said order passed by CIT(A), the assessee filed an appeal before the Hon'ble ITAT.

Decision of the Tribunal:

The Hon'ble Tribunal held as under:

- The payment made to non-resident for technical services provided to the assessee is admittedly taxable in India, therefore, the assessee is bound to deduct tax. The assessee can claim the same as expenditure. However,

such claim of expenditure could be allowed only in case the assessee deducts the tax at the time of payment. In this case, the assessee claims that deduction was not claimed as expenditure while computing the income chargeable to tax. The Commissioner (Appeals) observed that irrespective of the fact that whether the assessee has claimed as deduction or not disallowance has to be made since tax was not deducted. Both the authorities have not examined whether the amount paid to the non- resident was deducted while computing the income chargeable to tax or not. In order words, even though the assessee claims that the payment to non-residents was not claimed as expenditure while computing taxable income, the same was not examined by any of the lower authorities.

- The language of section 40 of the Act clearly says that the amount paid to non-resident on which tax was not deducted shall not be deducted while computing the income chargeable to tax. Therefore, if the assessee has not deducted the amount claiming as expenditure while computing the chargeable income, there is no necessity for further disallowance

Thus, if the assessee has not claimed the payment to non-resident as expenditure and not deducted while computing the income chargeable to tax, there is no question of further disallowance.