October, 2014

DIRECT TAX UPDATE

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

1. Transfer Pricing

a. CIT Vs. M/s Voest Alpine A.G. (ITA No. 79/2001 and 80/2001-Delhi High Court)

Consideration received for furnishing technical services, would not be treated as 'royalty' under DTAA of India and Austria. Consideration received for furnishing technical services outside India shall not be taxable in India.

Facts of the case:

The assessee, a company incorporated and resident of Austria, had entered into an agreement for Technical Assistance for Small Hydro Power Plants dated 23rd May, 1986, with Punjab Power Generation Machines Limited (PPGML). The assessee, as per recitals in the said Agreement, was custodian of advance and valuable technology for producing hydro power equipment on the basis of information gathered, researched and developed over years.

The assessee had agreed to furnish to PPGML, know-how and technical assistance for manufacture of such equipment and

marketing the same on the terms and conditions set out therein**.** PPGML, during and after the Agreement, was entitled to use the information in the territory of India, Nepal, Bhutan, Bangladesh and Sri Lanka. Further, PPGML had the right to export products outside the territory (India) except Austria and other countries where the assessee had entered into arrangements on the date of agreement.

The assessee received consideration for information and services in three installments. Rs.41,61,083/- representing the first two installments in clause 4.1 of the agreement were received in the period relevant to the assessment year 1989-90 and the third installment of Rs.30,07,889/- was received in the period relevant to the assessment year 1990-91. The payments received were claimed to be exempt or not taxable being consideration for technical services.

The AO treated the entire amount received under clause 4.1 as royalty taxable under Article VI of the DTAA between India and Austria.

The Commissioner of Income Tax (Appeals) deleted the said addition, observing that the lump-sum fee payable under clause 4.1 of the agreement was for technical services furnished in Austria and covered under Article VII of the DTAA. The Tribunal in the impugned order examined clauses 4.1 and 4.2 of the agreement and Articles of the DTAA to hold that the payments made under clause 4.1 were for technical service covered by Article VII of DTAA which were furnished in Austria. The assessee did not have place of work in India, and therefore, payments made under clause 4.1, being lump-sum payments were not liable to tax in India.

Decision of the High Court:

Revenue filed an appeal before the High Court which gave relief to the assessee as under -

- The word 'technical' could mean and would include scientific work, patents, designs or secret processes etc. expressly covered under Article VI. However, what was not covered and mentioned in the said Article was services. The word service in the context of Article VII endorses reference to rendering consultation, providing guidance, imparting skills and technical information relating to implementation and actual working, in contradiction to grant of right to use technical know-how, patent, secret processes etc. Making available and permission / grant of right to use stood contrasted from rendering of services in relation to technology and technical matters. Rendering service would be beyond or greater than simply or solely granting 'right to use' in the 'goods' specified in paragraph 2 of Article VI.

- In the present case, the assessee provided services to PPGML which were of technical nature as they were related to and required special knowledge of applied science, thus would qualify and were 'technical services'. In the light of DTAA, where the foreign entity had provided technical services and received consideration for the same, it would be covered under Article VII and not under Article VI of the DTAA.

- The lower appellate authorities have primarily gone by the heading of clauses 4.1 and 4.2 of the agreement to draw distinction between the consideration paid for services and consideration paid for royalty. They have not, examined

the question of bifurcation of consideration or drawn distinction between the services which were actually rendered in India and services which were rendered outside India.

- The amounts should be bifurcated and amounts covered under Article VI should be taxed in India and the amounts covered under Article VII should be taxed in India only if they were attributable to activities actually performed in India, after deducting expenditure.

Thus, the consideration received under clause 4.1 of the agreement for information and services, shall be taxable in the following manner:-

i) Consideration received for technical services would be taxable under Article VII of the DTAA, to the extent the amounts were attributable to the activities performed by the respondent-assessee in India. Deduction of expenses would be made.

ii) Consideration paid for right to use technical information and know-how would be taxable under Article VI of the DTAA.

iii) The consideration paid for furnishing technical services outside India, shall not be taxable in India.

b. CIT Vs. M/S SAP Labs Pvt. Ltd. (IT Appeal No. 842 of 2008 - Karnataka HC)

TPO's acceptance of ALP shows two views are possible and CIT has no jurisdiction to revise assessment

Facts of the case:

The assessee filed a return of income for assessment year 2002-03 on 31st October, 2002. The same was processed under Section 143(1) of the Income Tax Act. The assessee received notices by Assessing Officer ("AO") dated 1st of April, 2004 u/s 148 of the Act for reopening of assessment and 12th April 2004 under Section 92CA of the Act from the Transfer Pricing Officer seeking details about the international transactions entered into by the assessee with the group companies on a reference made by the AO.

In reply to the notice issued u/s 148 of the Act, the assessee filed a letter dated 21st April, 2004 requesting the AO to treat the ROI filed on 31-10-2002 as return in compliance with the notice u/s 148 of the Act. The TPO on 20th January, 2005 passed an order u/s 92CA of the Act without making any adjustments.

The CIT passed an order u/s 263 of the setting aside the assessment order of the AO on the ground that it was erroneous and prejudicial to the interest of the revenue, where the order was passed on non-application of mind.

On appeal by the assessee, the Tribunal held that when two views are possible and when the Transfer Pricing Authority has accepted valuation by the AO determining the arm's length price, the Commissioner had no jurisdiction to interfere with the said order u/s 263 of the Act. Accordingly, the Tribunal has set aside the order of the Commissioner.

Revenue filed an appeal before the High Court.

Decision of the High Court:

The Hon'ble High Court held that it is clear that on the day the reference was made by the AO to the Transfer Pricing Authority, there was no return pending for consideration and therefore the very reference was bad. Even otherwise, the said Transfer Pricing Authority did not find fault with the adjudication of determining ALP by the AO.

Thus, the Commissioner had committed an error in exercising his power u/s 263 of the Act and the Tribunal was justified in interfering with the said order.

2. Domestic Taxation

a. CIT Vs. Pushpendra Surana (264 CTR 204) (Rajasthan HC)

Concealment penalty not imposable, if revised return was accepted by the assessing authority and there was no material available on record that it was a deliberate concealment on part of assessee

Facts of the case:

The assessee filed original return of income on November 17, 2004 for the assessment year 2004-05. However, at a later stage, a notice for reassessment u/s 148 of the Income tax Act was issued to him on July 16, 2007.

On receipt of notice for reassessment, the assessee filed revised return disclosing income from long term capital gain on account of sale of agricultural land. The said return was

accepted by the Assessing Officer and assessment was completed.

Thereafter, penalty proceedings were initiated considering it to be a case of deliberate concealment made by the assessee and after affording opportunity of hearing, penalty was inflicted upon the assessee. The Commissioner (Appeals) as well as the Tribunal deleted imposition of penalty.

Decision of the High Court:

The High Court upheld the order of the lower authorities and held as under:

- The Commissioner (Appeals) and the Tribunal both have considered the matter, in detail, and finally arrived at a conclusion that the income declared by the assessee from the long-term capital gain by selling agricultural land in his revised return was accepted by the assessing authority and there was no material available on record by which there could be an inference drawn by the authority that it was a deliberate concealment on the part of the assessee and it could not be considered that there was an inaccurate particular of income that was made the basis for inflicting penalty upon the assessee in exercise of powers conferred under section 271(1)(c).

- Taking note of the submissions and the order passed by the Commissioner (Appeals) and the Tribunal, no substantial question of law arises in the instant appeal which may require consideration.

Thus, no penalty if AO had accepted revised return

without stating any deliberate concealment on part of assesse.

b. Highlight Pictures (India) (P.) Ltd. Vs. ACIT 30 ITR (T) 475 (Mumbai - Trib.)

Where tax was deducted by assessee, even if same was under wrong provisions, section 40(a)(ia) cannot be invoked to disallow same

Facts of the Case:

The assessee-company deducted TDS u/s 194C on the payment made for art designing, film post production and location hire charges.

The AO noticed that the assessee has deducted the TDS @ 2.06% u/s 194C whereas the TDS should have been deducted @ 5.61 per cent u/s 194J of the Act since the services rendered were in the nature of editing of films i.e. services were in the nature of professional / technical services. The AO was of the view that where specific provisions for deduction of tax at source are provided u/s 194I or 194H, then the provisions of residuary section 194C wouldn't apply.

On appeal, the Commissioner (Appeals) confirmed order of the Assessing Officer. The assessee filed an appeal before the Tribunal.

Decision of the Tribunal:

The Hon'ble Tribunal held that the provision of section 40(a)(ia) can be invoked only when tax has not been deducted or has not been paid as per the provisions. In case the assessee

has already deducted tax, if not u/s 194I or 194J but under section 194C, it is not a case of non-deduction of tax as per the import of section 40(a)(ia). When tax was deducted by the assessee, even under bona fide impression under wrong provision of TDS, the provisions of section 40(a)(ia) cannot be invoked. This principle is being followed uniformly by various co-ordinate Benches and has the approval of the Hon'ble Calcutta High Court in case of **CIT v. S.K. Tekriwal (361 ITR 432)** relied on by the assessee.

Therefore, tax deduction under wrong provisions on account of bona-fide belief won't attract sec. 40(a)(ia) disallowance.

c. Eqbal Inn & Hotels Ltd. Vs. JCIT (IT APPEAL NOS. 876 TO 879 (CHD.) OF 2013)

Money accepted as share application money cannot be termed as loan or deposit for purpose of section 269SS read with section 271D

Facts of the Case:

The assessee-company was constructing a hotel and loan has not been sanctioned by the financial institutions and banks. The assessee company fall back to the sources of the directors for the construction of hotel. The money has been transferred at the end of the every year to share application account.

The Assessing Authority having noticed that the assessee-company had accepted share application money in cash from its directors in violation of provisions of section 269SS, imposed penalty under section 271D. On appeal, the Commissioner (Appeals) upheld penalty order. The assessee

filed an appeal before the Tribunal.

Issues before the Tribunal

1. Whether the assessee has contravened the provisions of section 269SS?

2. Whether the levy of penalty is mandatory?

Decision of the Tribunal:

The Tribunal held as under-

- In the normal business world, a loan connotes a transaction in which borrower approaches the lender for a certain sum for a fixed period on the terms and conditions which may be agreed between borrower and lender which would include the rate of interest, tenure of the loan and other conditions regarding security etc. Similarly, the word 'deposit' would connote a transaction in which the depositor gives to another person generally a bank or some other person a deposit of his belongings which may be money also on certain terms and conditions e.g. in case of a bank the depositor would deposit the money to be refunded after certain period along with pre-defined interest. Deposits can also be made by person for assuring the other of the performance of a contract e.g. in case of bailment contracts.

- The **Jharkhand High Court** in case of **Bhalotia Engg. Works (P.) Ltd.Vs. CIT (275 ITR 399)** has opined that even share application money would amount to deposit. However, the Delhi High Court in the case of **CIT Vs. I.P. India (P.) Ltd. (343 ITR 353)** differed from this

view. The Hon'ble High Court in this case observed that in case of **Baidya Nath Plastic Industries (P) Ltd. Vs. K.L. Anand, ITO (230 ITR 522),** the Single Judge of this Court pointed out that the distinction between a loan and a deposit is that in the case of the former it is ordinarily the duty of the debtor to seek out the creditor and to repay the money, according to the agreement, while in the case of a deposit it is generally the duty of the depositor to go to the banker or to the depositee as the case may be, and make the demand for it. The Hon'ble High Court further noted that this observation was approved later by Division Bench in the case of **DITVs. Acme Educational Society (326 ITR 146) (Delhi)**. The Hon'ble High Court further observed that if these tests were applied then share application money for allotment of shares in a company cannot be treated as a receipt of loan or deposit.

- The Hon'ble Madras High Court in the case of **CIT Vs. Idhayam Publications Ltd. (285 ITR 221)** has clearly held that if money has come into current account and no interest was being charged for the same, then that would not be covered by the definition of loan and deposit as envisaged in section 269SS. In that decision it has been further emphasized that as per Companies (Acceptance and Deposit) Rules, 1975 deposit would not include any amount received from the Director or shareholder of the company, therefore, this amount cannot be termed as loan or deposit for the purpose of section 269SS read with section 271D and therefore, penalty could not have been imposed. If such situation is examined from another angle that if the money is accepted as share application money then the same cannot be construed again as loan or

deposit as held by Delhi High Court in the case of **I.P. India (P) Ltd.(supra)**.

- In any case, a reasonable cause was also explained that assessee-company was constructing a hotel for which bank loans were not sanctioned and, therefore, directors had to contribute the money towards construction of the hotel. The payment was generally required for labour payments and other cash items, therefore, it is a reasonable cause for accepting the cash from directors and relatives and even on this basis also penalty is not leviable.

Thus, acceptance of share application money in cash couldn't be deemed as loan or deposit in violation of sec. 269SS

d. CIT Vs. M/S K. Raheja Development Corporation (IT APPEAL NO. 661 of 2007)

Interest paid on borrowed loan advanced to its sister concern cannot be claimed as deduction automatically when the loan is advanced as interest free loan.

Facts of the Case:

The assessee is a firm engaged in the business of real estate development. AO noticed that the assessee has received money by way of capital introduction by partner and loan given by various other parties. The assessee has given interest on most of these funds and charged to profit and loss account. The assessee has also advanced funds to various parties including its sister concern and in many cases of such lending, no interest has been collected.

An analysis of the accounts reveals that on the amount received from M/s. Ivory Properties Pvt. Ltd., the assessee has paid interest at 18% p.a. and charged to profit and loss account. On the amount given as loan to M/s. K Raheja Hotels and Estates Private Limited, the assessee has not charged and collected any interest.

The AO was of the view that the assessee has diverted the borrowed funds, in which interest is incurred, to non-business purposes, where the assessee has not earned any interest. Therefore, interest charged to profit and loss account on the amount diverted for such non-business purposes could be treated as non-business expenditure and therefore, the said amount was disallowed.

The assessee filed an appeal before the CIT (Appeals), who affirmed the said order. Being aggrieved by the order passed by the CIT (Appeals), the assessee filed an appeal before the Tribunal.

The Tribunal held that the dispute existed between the partners namely, M/s. K Raheja Development Corporation, M/s. Unique Estates Development Corporation, M/s. Sea-Crust Properties Pvt. Ltd. and other company and the same is clearly proved by evidence. It further held that as per the judgment of the Apex Court in the case of **S. A. Builders Ltd. Vs. CIT(A) 288 ITR 1 (SC)**, comes to the rescue of the assessee. Therefore, the compelling reasons of dispute followed by the requirement of arbitration, interest is not being chargeable and therefore, it cannot be said that the assessee diverted the funds. Therefore, it set aside the order passed by the lower authorities and upheld the claim of the assessee for disallowance.

Aggrieved by the said order, the Revenue filed an appeal before High Court.

Decision of the High Court:

- The Apex Court in case of **S. A. Builders** has made it clear that it is not their opinion that in every case interest on borrowed loan has to be allowed if a assessee advances it to a sister concern. It all depends on the facts and circumstances of the respective cases. **If the interest free loan was given to the sister company as a commercial expediency, then interest paid on such loan could be allowed;**

- Therefore, it is clear that interest on borrowed loan advanced to its sister concern cannot be claimed as deduction automatically; and

- Merely because the sister concern getting into litigation or involving itself in a arbitration proceedings to which the holding company is nowhere responsible, cannot be made a ground for allowing deduction. The understanding of the Tribunal on the judgment of the Apex Court is incorrect and the reason assigned by the Tribunal is not satisfactory.

Thus, interest paid on loan borrowed and advanced it to its sister concern cannot be allowed as deduction.

enforceable for any reason, the remainder shall nonetheless continue to apply.