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INDIA TAX

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In this edition of our thought leadership publication, we have tracked the progress of some significant cases decided by the appellate forums across the country along with important press releases issued by the Central Board of Direct Taxes.

CASE LAW 1:

Firmenich Aromatics India (P.) Ltd. Vs. DCIT [2018] 96 taxmann.com 649 (TMum)

TPO couldn't determine ALP on estimation basis merely because assessee didn't furnish certain documents as evidence.

Facts of the case:

The assessee had paid an amount for availing Software Services. The assessee submitted that the cost of software charges was substantial and mandatory and had to be incurred by the assessee either through AE or directly, since, the business of the assessee had to be run, controlled, managed by the computer system with the help of application software.

The TPO opined that the assessee had failed to demonstrate that services had in fact been provided, the basis for quantification of the payment made, etc. Though the TPO admitted that the AE had provided the software, however and held that in the absence of specific details towards services rendered to the assessee, the quantification of value of the services rendered by the AE had to be done by way of estimation. Accordingly, the TPO proceeded to quantify the arm's length price of the payment made by stating that the number of man hours rendered by the employees towards rendering of services to the assessee was two man hour per day i.e., 365 man hour per year. Applying the man hour rate of Rs. 8,05,000 per hour, which according to the TPO could be considered as a CUP, he determined the arm's length price of the services availed by the assessee.

Aggrieved by the order of TPO, the assessee approached the Dispute Resolution Panel('DRP') who ruled in favor of the revenue. The assessee appealed against the order of the DRP.

Decision of the Hon'ble Tribunal:

The Tribunal addressed the following points in its ruling:

- The TPO has alleged that the assessee failed to furnish any evidence to substantiate its claim that the payment is made to the AE for availing Information System Services, however, the material on record reveal that the assessee has not only undertaken a benchmarking process for determining the arm's length price of the transaction in the transfer pricing study report which was filed before the TPO, but, other relevant and necessary documents like copy of the agreement, invoices raised, certificate from independent Chartered Accountant Firm details of users were also furnished before the TPO.
- Therefore, the allegation of the TPO that the assessee has not furnished the necessary details is not totally correct. In any case of the matter, non-furnishing of certain documentary evidences, as alleged by the TPO does not empower him to embark upon determining the arm's length price of the international transaction on estimation basis.
- Further, a reading of the TPO's, order makes it clear that his finding on the issue is contradictory. On the one hand, he has observed that the assessee has failed all the three tests, including, whether the services have actually been provided, on the other hand, he has accepted that the AE has provided the software. Thus, ultimately, what the TPO disbelieves is the quantum of payment. Accordingly, he has proceeded to estimate the price of the services rendered by the AE at Rs. 1,62,05,000.
- Though, the TPO has observed that the assessee has applied CUP method for determining the arm's length price, however, the assessee has not brought on record even a single comparable to support the arm's length price determined by him even on estimate basis. The estimation of service charges on so-called man hour basis is without any supporting material. Similarly, the estimation of cost of software was without any basis. Thus, it is very much clear that the determination of arm's length price by the TPO is not as per any one of the methods prescribed under section 92C read with rule 10B. Such determination of arm's length price on ad hoc/estimation basis is not permissible under the scheme of the Act as the Transfer Pricing Officer is duty bound to determine the arm's length price by following any one of the most appropriate method prescribed under the statute.
- If the TPO did not agree to the arm's length price shown by the assessee is it open for him to determine the arm's length price by applying one of the most appropriate methods being backed by supporting material. Without complying to the statutory provisions, the TPO certainly cannot determine the arm's length price on ad hoc/estimation basis.

Accordingly, the adjustment made to the arm's length price of payment made towards availing information system services from AE was deleted.

INTERNATIONAL TAX

CASE LAW 1:

EPRSS Prepaid Recharge Services India Pvt Ltd Vs. ITO [ITA No.828/PUN/2016] (TPUN)

Payments made for web hosting services are business income and not in the nature of royalties. In the absence of a permanent establishment of the non-resident payee in India, the payments would not be subject to a withholding tax in India.

Facts of the case:

The assessee was engaged in the business of distribution of recharge pens of various DTH providers like Idea cellular and Sun Direct TV (P.) Ltd. to its distributors via online network. The assessee made payment for web hosting charges to Amazon Web Services LLC ('AWS') during the AY on which no tax was deducted on the ground it is not taxable in India. However, the AO held that the said payment is in nature of royalty as per Amendment to section 9(1)(vi) of the Act by Finance Act ,2012 and consequently liable for TDS Since the same was not deducted the said amount paid to AWS was not allowed as deduction in the hands of assessee.

Before the Hon'ble CIT(A), the assessee contended that, Amazon doesn't have permanent establishment ('PE') in India and therefore, its income is not taxable in India. The said payment to Amazon is not in nature of royalty as section 9(1)(vi) of the Act. Assessee submitted precedents in respect of billing and payment for various services received from amazon and reiterated that payee is not chargeable to tax in India and hence there is no liability to deduct tax u/s 195 of the Act.

On appeal, the Commissioner (Appeals) upheld the order of the AO.

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

Decision of the Hon'ble Tribunal:

The Tribunal addressed the following points in its ruling:

- The fees paid by assessee was for use of technology and cannot be said to be for use of royalty, which stands proved by the factum of charges being not fixed but variable i.e. it varies with the use of technology driven services and also use of such services does not give rise to any right in property of Amazon and consequently, Explanation under section 9(1)(vi) of the Act is not attracted.
- Explanation 2(iva) of section 9(1)(vi) of the Act covers cases of royalty i.e. consideration paid for the use or right to use any industrial, commercial or scientific equipment but not including the amount referred to in section 44BB of the Act. The assessee in the present case did not use or acquire any right to use any industrial, commercial or scientific equipment while using the technology services provided by Amazon and hence, the payment made by assessee cannot be said to be covered under clause (iva) to Explanation 2 of section 9(1)(vi) of the Act.
- Even if the retrospective amendment is held to be applicable, the case of assessee of payment to Amazon being outside the scope of said Explanation 2(iva) to section 9(1)(vi) of the Act, cannot make the assessee liable to deduct tax at source.

- The assessee is not liable to deduct withholding tax and such non deduction of withholding tax does not render the assessee in default and consequently, no disallowance of amount paid as web hosting charges is to be made in the hands of assessee for such non deduction of withholdings tax and hence, provisions of section 40(a)(i) of the Act are not attracted.

Based on the above conclusions, the Tribunal concluded that tax was not required to be withheld on the Payments, since they did not constitute royalties. Consequently, disallowance was not warranted.

DOMESTIC TAX

CASE LAW 1:

Kohinoor Industrial Premises Co-operative Society Ltd. Vs. ITO [2018] 98 taxmann.com 365 (TMum)

Income earned by letting out space on terrace for installation of mobile tower/antenna is taxable under the head Income from House Property and thus deduction u/s 24(a) will be available in respect of the same.

Facts of the case:

The assessee is a co-operative society. The assessee has let-out some space on the terrace of the building to the cellular operators for installing and operating the mobile towers/ antenna for the purpose of providing mobile telecom services. The assessee offered the income derived from letting out this space as income from house property ('IFHP'). The assessee claimed a deduction u/s 24(a) against this income offered.

The Assessing Officer ('AO') observed that terrace cannot be termed as house property as it is common amenity for members. Also, the annual letting value of the terrace is not ascertainable, AO concluded that the income received by assessee from letting out space on the terrace should be treated as income from other sources. Further, the AO disallowed assessee's claim u/s 24(a).

On appeals, the Commissioner (Appeals) upheld the order of the AO. Aggrieved by the order of CIT(A), the assessee filed an appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal held that the income received by the assessee from the cellular operators/mobile companies is on account of letting out space on the terrace for installation and operation of antennas and nothing else. That being the case, the rental income received by the assessee from such letting-out has to be treated as income from house property. Further, the contention of the assessee that in no other assessment year, the assessee's

claim of such income as house property has been disturbed by the Assessing Officer has not been controverted by the departmental. Therefore, there being no material difference in fact, applying rule of consistency also, assessee's claim deserves to be allowed.

Accordingly, it was held to treat the rental income received by the assessee from cellular operator as income from house property and allow deduction under section 24(a) of the Act.

CASE LAW 2:

Hansa Shah Vs. ITO [IT APPEAL NO. 607 OF 2018] (TMum)

Deduction u/s 54 of the Act could not be disallowed on the mere fact that the funds from housing loan were utilized for purchase of new house property.

Facts of the case:

The assessee company filed its income tax return which included capital gain from sale of house property. While computing the capital gain in the income tax return, the assessee claimed exemption u/s 54 of the Act against purchase of new house property. During the relevant year, the company had taken a housing loan. The AO rejected the exemption claimed u/s 54 of the Act by reducing the amount of loan from the cost of new house and accordingly made additions towards long term capital gains.

Aggrieved by the order of the AO, the assessee preferred an appeal before the Hon'ble CIT(A). The CIT(A) upheld the order of the AO.

Aggrieved by the order of CIT(A), the assessee preferred an appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal held that the only condition to claim the exemption u/s 54 of the Act is that the new house property should be purchased within the stipulated time period. The exemption u/s 54 of the Act cannot be withdrawn even if the funds from housing loan are utilized to purchase the house property. The exemption is allowed irrespective of the fact that the new house property is purchased out of the sales consideration of the house property sold or from the housing loan.

Therefore, the Hon'ble Tribunal sets aside the order of the Hon'ble CIT(A) and allows the appeal of the assessee.

CASE LAW 3:

Pinebridge India (P.) Ltd. Vs. ACIT [IT APPEAL NO. 2470 OF 2011] (TMum)

Exp. to be allowed if necessary steps have been taken to commence business after incorporation.

Facts of the case:

The assesee was an Asset Management Company (AMC) formed to manage the mutual fund schemes of AIG Global Investment Group Mutual fund (the Fund) in accordance with the Investment Management Agreement (IMA) entered into between the assessee and AIG TCIP (trustee company). The assessee filed its return of income returning a loss of certain

amount. The assessee had claimed several expenditure related to grant, electricity charges, repairs and maintenance etc.

The Assessing Officer disallowed the expenditures claimed by the assessee for reason that the assessee was not engaged in any business as appearing from the copies of accounts. He held that the claim of the assessee as to allowance of deduction of expenditure subsequent to the date of entering into Investment Management Agreement was also not acceptable on the ground that only entering into Investment Management Agreement did not confer the assessee to expend without getting any corresponding reimbursement as per agreement. In fact, though there was reflection of expenses in the accounts, there was no reimbursement of the same or even, no effect was made for reimbursement of expenses as appearing from the accounts.

On appeal, the Commissioner (Appeals) also upheld the order of the Assessing Officer.

Aggrieved by the order of CIT(A), the company preferred an appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

It is also observed that the expenses incurred by the assessee are its routine expenses incurred in conduct of its business of Asset Management Company. The assessee is in the business of asset management and in terms of SEBI regulations and the agreement with the trustee company; it is required to incur these expenses for the purpose of its business. The Assessing Officer has not appreciated the fact that entering into agreement is sufficient enough to carry on its business. It could not have carried on its business of Asset Management Company without entering into Investment Management Agreement. Accordingly, Assessing Officer was not correct in holding that entering into agreement did not confer upon the assessee to expand without getting any corresponding reimbursement of expenses. From the record, it is also found that the accounts and schedules thereto are prepared as per companies Act, 1956 and in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India. The accounts of assessee are duly audited.

In the instant case, assessee company has been incorporated to manage the assets of the mutual funds and it is incorporated with the said object. Upon its incorporation, assessee took various steps to commence its business such as hiring of people application to SEBI, organizing for space etc, and this amounted to setting up business and the entire expenses ought to be allowed. In any case, to acting as an AMC for the fund, it is necessary for it enter into an Investment Management Agreement with the trustee company, which was entered into by the assessee. The assessee thereon started the process of launch of the fund. The assessee successfully launched the first fund in May, 2007. As stated earlier, it has already started its activities for launching of fund.

In view of the above, it is held that the Assessing Officer was not justified in not accepting the claim of the assessee that its business activities are commenced from the date of its incorporation.

Thus, the expenses incurred for commencing its business such as hiring of people, application to SEBI, organizing for space etc., amounted to setting up of business, therefore, expenditure incurred by assessee are allowed.

RECENT IMPORTANT CIRCULARS, NOTIFICATION AND PRESS RELEASE ISSUED BY THE CENTRAL BOARD OF DIRECT TAXES ('CBDT')

1. PIB PRESS RELEASE, DATED 27-10-2018

Government of India has notified the Electoral Bond Scheme 2018 vide Gazette Notification No. 20 dated 02nd January 2018. As per provisions of the Scheme, Electoral Bonds may be purchased by a person (as defined in item No.2(d) of Gazette Notification), who is a citizen of India or incorporated or established in India. The Electoral Bonds shall be encashed by an eligible Political Party only through a Bank account with the Authorized Bank. Electoral Bonds shall be valid for fifteen calendar days from the date of issue and no payment shall be made to any payee Political Party if the Electoral Bond is deposited after expiry of the validity period.

A link for the same is provided herewith:
pib.nic.in/PressReleseDetail.aspx?PRID=1550963

2. NOTIFICATION NO.78/2018 [F.NO.500/05/2018-FT&TR-III], DATED 5-11-2018

In exercise of the powers conferred by section 285BA of the Income-tax Act, 1961 read with sub-clause (ii) of clause (D) of the Explanation to clause (6) of rule 114F of the Income-tax Rules, 1962, the Central Board of Direct Taxes specified the foreign jurisdictions for the purposes of statement of financial transaction.

A link for the same is provided herewith:
https://www.incometaxindia.gov.in/communications/notification/notification78_2018.pdf

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