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PARTNERS BEYOND BOUNDARIES

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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.

TRANSFER PRICING

CASE LAW 1: MITCHELL DRILLING INDIA (P.) LTD. VS. DCIT ITA NO. 5921/DEL/2010 [TDEL]

Where it is proved that the international transaction is not genuine, transfer pricing provisions are not triggered. Further, neither any income can arise nor any deduction can be allowed as a result of such transaction.

Facts of the case:

The assessee is a joint venture between M/s Mitchell Drilling International Pty Limited ('Mitchell Singapore') and Rajbhara Consultants Pvt. Ltd. The assessee is engaged in the development of burgeoning CBM industry, directional drilling and innovative turnkey management projects within the oil and gas industry.

During the assessment proceedings, four international transactions with the associated enterprise ('AE') were under consideration *viz* `Purchase of components and accessories'; `Payment of interest under purchase agreement'; 'Payment of installments of principal under hire purchase agreement'; and `Repossession of rig'. All such transactions were closely related to the assessee purchasing a drilling rig from Mitchell Singapore on hire purchase under an agreement. The Assessing Officer ('AO') made a reference to the Transfer Pricing Officer ('TPO') for determining the arm's length price ('ALP') of the international transactions.

As the assessee was unable to furnish the invoice for purchase of rig, the TPO was of the view that it could not be ascertained whether or not the transaction was carried out at an ALP. Further, the price at which the rig was repossessed as well as the price at which the purchase of components and accessories was executed were not substantiated by the assessee to be the ALP for the respective transactions. Also, it was found that the rig was utilized for a limited period of one year and three months as against term of hire purchase agreement consisting of a few years. In addition to that, the agreement has no clause of penal payment or any compensation in case of default in payment of hire purchase charges. Thus, the TPO was of the view that the

hire purchase was a sham transaction purposefully designed to avoid charging / withholding any tax on rental of Rig and also by claiming depreciation on Rig.

The TPO proposed to make the following additions to the assessee's income:

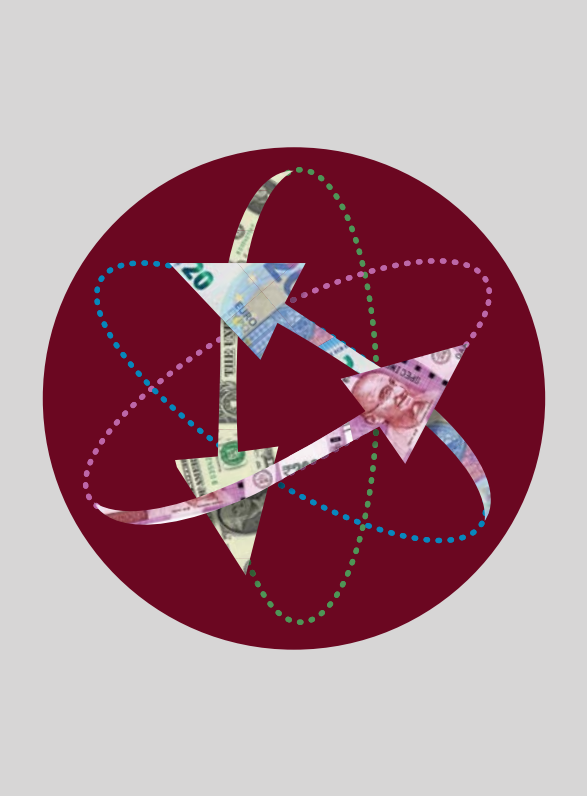
- As the assessee has not deducted tax at source on the payments made to non-resident, disallowance u/s 40(a)(i) of the Income Tax Act, 1961 ('the Act');
- Depreciation on rig was added back to the assessee's income;
- Transfer pricing adjustment.

Aggrieved, the assessee preferred an appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal opined that as the transaction was non-genuine, neither an income can arise nor any deduction can be allowed to the assessee on account of such a transaction. Consequently, deprecation on the rig should not be allowed as an expense to the assessee. Further, with respect to the transfer pricing adjustment, the Hon'ble Tribunal stated that ALP is always determined of an international transaction, which is genuine. If the transaction itself is not genuine, there can be no question of applying the transfer pricing provisions to it.

Therefore, the Hon'ble Tribunal partly allowed the appeal in favor of the assessee.



CASE LAW 2: EATON FLUID POWER LTD. VS. ACIT [2018] 92 TAXMANN.COM 158 [TPUN]

International transactions intrinsically linked to each other and related to the business of the assessee can be aggregated.

Facts of the case:

The assessee Eaton Fluid Power Limited is a wholly owned subsidiary of Eaton Corporation, which is engaged in the manufacture and distribution of fluid power equipment such as pumps, gear pumps, valves, cylinders and related components for mobile and industrial markets. The assessee had entered into international transactions for import of raw materials, trading goods and components, export of finished goods, income from services, information technology ('IT') services availed and reimbursement of expenses with its AE.

Considering that all these transactions were interdependent, the assessee had aggregated the first five transactions using Transactional Net Margin Method ('TNMM') while benchmarking the international transaction to be at ALP. However, TPO was of the view the transaction of IT services should be segregated. In the second instance, the TPO opined that the assessee failed to prove the receipt of IT services from its AE and benefits derived from such services. The assessee had not provided with the break up of services availed from the AE. The case of the TPO was that actual rendition of services was not established and also that the assessee has not shown the cost benefit analysis.

Thus, the TPO determined the ALP for the IT transaction to be Nil. Aggrieved, the assessee preferred an appeal before the Hon'ble Dispute Resolution Panel ('DRP'). However, the Hon'ble DRP upheld the TPO's order.

Aggrieved, the assessee preferred an appeal with the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal held that all the services received by the assessee from the AE were intermingled and also related to the business carried on by the assessee. Hence, the plea of the assessee to aggregate the transactions was accepted by the Hon'ble Tribunal. For the second instance, it was held that the role of the TPO is to determine the ALP of international transactions undertaken by the assessee and the TPO cannot sit in the judgement of the business module of the assessee and its intention to avail or not to avail any services from its AE. Also, the assessee had submitted additional evidence including copies of e-mail correspondence on sample basis evidencing the receipt of IT services and related support services such as accounting / finance / human resources, debit notes, JV vouchers, etc. Based on the factum of availing services, benefits received from those services as well as basis of charge was proved by the assessee and thus the contention of TPO of determining the ALP at Nil was deleted.

Therefore, the Hon'ble Tribunal ruled in favor of assessee, allowing the assessee to aggregate the IT transactions with other transactions and reversed the order of the TPO in taking the value of transaction of availing IT services at Nil.

INTERNATIONAL TAX

CASE LAW 1: SAMSUNG HEAVY INDUSTRIES CO. LTD. VS. DCIT (INT. TAXATION) [2018] 93 TAXMANN.COM 224 (TDEL)

Where alleged Permanent Establishment ('PE') in India has no role to play in the activities / tasks carried on outside India, no income from such offshore activities could be attributed to said alleged PE.

Facts of the case:

The assessee, Samsung Heavy Industries Co. Ltd, is a company incorporated in South Korea and a tax resident of South Korea. The assessee is engaged in the business of heavy engineering and had been awarded a project in India by M/s Oil and Natural Gas Corporation Ltd., India ('ONGC') for the purpose of surveys, design, engineering, procurement, fabrication, transportation, installation, testing, pre- commissioning, etc. Under the contract entered by the assessee with ONGC for the aforesaid activities, the assessee had to perform certain activities within India and outside India. The activities to be performed in India were installation and commissioning. At the instance of ONGC, the assessee opened a project office in India for the purpose of coordination and communication between the parties to the contract. For the concerned AY, the assessee filed its return of income declaring loss relating to activities performed in India i.e. installation and commissioning. The AO was of the view that the assessee has a fixed place Permanent Establishment ('PE') in India under the India-South Korea Double Tax Avoidance Agreement ('DTAA') and thereby attributed the revenue from activities carried on outside India to the alleged PE of the assessee in India, setting aside the returned loss claimed by the assessee.

The assessee contended that the alleged PE had no role to play in design, fabrication, etc. of the platforms which was carried on outside India. The AO rejected the assessee's contention. The AO also rejected the accounts of the assessee in respect of the operations carried on inside and outside India and further rejected the audited accounts of the assessee in respect of operations carried out inside India without pointing out any deficiency in the said accounts. The AO attributed, an adhoc 25% of the gross revenues, received by the assessee (based on past projects carried out in India) to the alleged PE.

On appeal, the Hon'ble CIT(A) confirmed the AO's order. Aggrieved, the assessee preferred an appeal before the Hon'ble Tribunal.

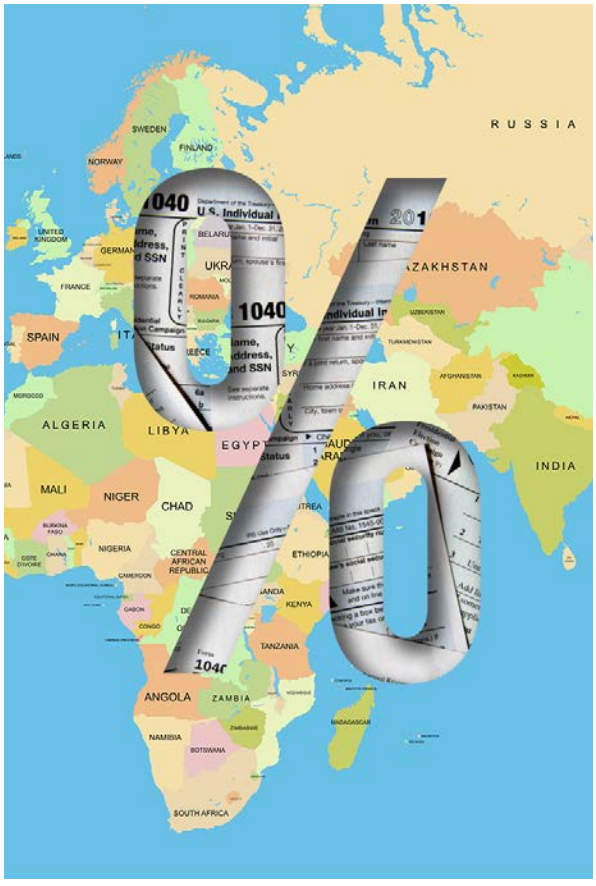
Decision of the Hon'ble Tribunal:

The assessee contended that in order to bring offshore supplies to tax in India, the revenue ought to place evidences on record to demonstrate that the PE played any role in the offshore supplies. The Hon'ble Tribunal noted that the revenue had no evidence to substantiate the claim to support attribution of gross revenues earned by the foreign enterprises, including the revenues earned outside India to the project office, and imputing a profit margin of 25% thereon.

In this regard, the assessee placed reliance on National Petroleum Construction Co. Vs. DIT (Int. Taxation) [2016] 66 taxmann.com 16/238 Taxman 40/383 ITR 648 which stated that the burden to establish that the assessee was carrying out offshore supply of platforms or any part thereof, through its PE and further, the fact that the assessee had placed on record any material to establish that the project office in India had any role to play in respect of offshore activities i.e. supply of fabricated platforms that had been procured, engineered and fabricated outside India and had also been supplied from outside India.

In view of the fact that the revenue did not bring on record any evidence or material in support of the contention that the office in India had any role to play in respect of offshore supplies made and consequently, such income could be attributed to the alleged PE and on the other hand the assessee has placed on record its annual accounts, in support of the contention that the office in India had absolutely no role to play in respect of offshore supplies, the Hon'ble Tribunal was of the opinion that no income from offshore supplies could be attributed to its alleged PE in India.

Therefore, the Hon'ble Tribunal ruled in favour of the assessee.



DOMESTIC TAX

CASE LAW 1: M/S. PRATIK SYNTEX PRIVATE LTD. VS. ITO ITA NO. 6690/MUM/2016 [TMUM]

Where assessee is unable to prove genuineness and creditworthiness of the shareholders, receipts shall be treated as unexplained credit and taxed u/s 68 of the Act.

Facts of the case:

The assessee was a dealer in textiles yarn and also a commission agent. During the course of assessment proceedings, the AO observed that the assessee had raised new share capital for which the assessee was asked to prove identity and creditworthiness of all the new shareholders as well as the genuineness of the transaction of raising share capital. The AO observed that all the confirmations from the three corporate shareholders of the assessee were signed by a single person. Further, the assessee could not submit any documents / evidence to prove genuineness and creditworthiness of these three investing companies. In order to further investigate, the AO deputed an inspector to make field inquiries and verify the position of the shareholders. The investor stated that the shareholders were not available on the registered address. The assessee was confronted about the results of the additional enquiry being conducted by the inspector. In response to the same, the assessee could only submit unsigned copies of financial statements of the investee companies. The AO observed that the total share capital (inclusive of share premium) of the assessee company was INR 3.37 crores, out of which INR 3 crores had been invested by these three new shareholders which comes to 89.02% of the total capital fund of the assessee company. The assessee had not been able to trace these three new shareholders. The onus was on the assessee to prove identity, genuineness and creditworthiness of these three new shareholders. The AO treated the receipt of the share capital premium to be unexplained and unproved, and therefore, chargeable to tax within the deeming fiction of section 68 of the Act, which led to the additions to the tune of INR 3 crores.

Aggrieved by the order of the AO, the assessee preferred an appeal before the Hon'ble CIT(A). The Hon'ble CIT(A) affirmed the AO's assessment order keeping in mind the deeming provisions of section 68 of the Act as the assessee could not discharge its onus to prove the identity, creditworthiness and genuineness of the transaction.

Before the Hon'ble Tribunal, the assessee submitted that there was an amendment in section 68 of the Act, which provided that the AO cannot question the source of source of the investment. The assessee contended that the bank statements of the three investee companies i.e. shareholders submitted could prove as the source of the investment. The assessee further relied upon a number of decisions to support its contentions.

Against this, the revenue relied on the report of the inspector and the findings of the AO during the assessment proceedings. Further, the revenue relied on a few High Court decisions to back its contentions. Further, it stated that the bank statements of the investee companies did not even maintain a reasonable balance except for the transaction of payment for share capital. The money came into the bank account only for the purpose of the investment. There were no other significant transactions.

Decision of the Hon'ble Tribunal

The onus was on the assessee company to bring on record cogent evidences to prove the creditworthiness of the share subscribers and genuineness of the transaction. The assessee was not able to prove the genuineness and creditworthiness of the transactions. The additions made by the AO were affirmed by the Hon'ble Tribunal and the same were within the deeming fiction of the provisions of section 68 of the Act. The creditworthiness of the shareholders had not been proved from the bank statements as every payments made by them towards share money in favour of the assessee was preceded by deposit in the bank account of the new shareholders. The balance maintained regularly in their bank accounts had also been very miniscule. The assessee could not prove the genuineness of the transactions as well since no evidences of the strength of its financial statement were brought on record.

Thus, the Hon'ble Tribunal decided in the favour of the revenue and dismissed the appeal of the assessee.

CASE LAW 2: ACIT VS. BHARAT V. PATEL [2018] 92 TAXMANN.COM 386 [SC]

Receipt of consideration with respect to such SARs could not be liable to tax in the hands of the employee in absence of any express statutory provision to tax Stock Appreciation Rights ('SARs') in the hands of an employee, and to determine the cost of such SARs.

Facts of the case:

The assessee is a salaried employee at the post of Chairman-cum-managing Director of (P&G) India Ltd and the said company is the subsidiary of (P&G) USA. (P&G) USA issued SARs to the assessee without any consideration from the FY 1991 to the FY 1996. The said SARs were redeemed in the FY 1997 and in lieu of that the assessee received an amount of INR 68,040,724 from (P&G) USA. When the assessee filed his return of income, he claimed that this amount could only be treated as capital gains, however, since there was no payment made to acquire such SARs, the said capital gains could not be said to arise in the hands of the assessee. Hence, the assessee is of the opinion that no tax is payable on the same under the provisions of the Act.

During the assessment proceedings, the AO taxed the same as perquisite u/s 17(2)(iii) of the Act, contending that the assessee received the amount on redemption of the SARs in the capacity of an employee due to the existing employee employer relationship with (P&G) USA.

Aggrieved, the assessee preferred appeal before the Hon'ble CIT(A), where the decision was rendered in favour of the revenue. The assessee carried the matter before the Hon'ble Tribunal, which partly allowed the matter in favour of the assessee. On cross appeals by the assessee and the revenue before the Hon'ble High Court, the decision was rendered in favour of the assessee.

Aggrieved, the revenue preferred an appeal before the Hon'ble Supreme Court of India.

Decision of the Hon'ble Supreme Court:

The Hon'ble Supreme Court noted the following:

- In order to bring a specified security transferred by the employer to the employees within the ambit of tax as a perquisite, the legislature brought an amendment by inserting clause (iiia) in section 17(2) of the Act through the Finance Act, 1999 with effect from April 01, 2000, which was later on omitted by the Finance Act, 2000.
- It was the first time when the legislature specified the meaning of the cost for acquiring specific securities. By way of this amendment, the legislature clearly covered the direct or indirect transfer of specified securities from the employer to the employees during or after the employment.

The Hon'ble Supreme Court stated that on a perusal of the said clause, it is evident that the case of the assessee falls under such clause. However, since the transaction in the instant case pertains to prior to April 01, 2000, such transaction cannot be covered under the said clause in the absence of an express provision of retrospective effect.

The Hon'ble Supreme Court held that it is a fundamental principle of law that a receipt under the Act must be made taxable before it can be treated as income. It further held that courts cannot construe the law in such a way that brings an individual within the ambit of the Act to pay tax, who otherwise is not liable to pay. Thus in the absence of any such specific provision, if an individual is subjected to pay tax, it would amount to the violation of his Constitutional Right.

The Hon'ble Supreme Court thus held in favour of the assessee and dismissed the appeals preferred by the revenue. As per the current provisions of the Act, section 17(2)(vi) of the Act expressly provides for taxation of any specified securities or sweat equity shares as a perquisite, received by an employee from his employer. The benefit of SARs would also be covered under the ambit of this section, since it stems from the contract of employment. Keeping in mind the above, companies need to ensure that appropriate planning measures are in place especially for mobile employees who receive SARs from a foreign parent of an Indian subsidiary in order to maximize the wealth of the employees in a tax efficient and compliant manner.

CASE LAW 3: ITO VS. M/S TECHSPAN INDIA PRIVATE LTD. & ANR. CIVIL APPEAL NO. 2732 OF 2007 [SC]

Re-opening u/s 147 of the Act is not permissible merely based on 'change in opinion' by the AO.

Facts of the case:

The assessee was engaged in the business of development and export of computer software's and human resource services.

It claimed a deduction u/s 10A of 'the Act' on income earned from software export business and filed his return of income for AY 2001-02. The AO selected the case for regular assessment u/s 143(3) of the Act. On perusal of relevant records and based on consideration of various facts, the AO passed an order arriving at an income of INR 31,63,570 which was fully set-off against the loss brought forward and the income was assessed as 'Nil' for the AY 2001-02.

Further, few months after the order date, the revenue served a reopening notice u/s 148 of the Act on the assessee and subsequently passed an order assessing the income at INR 57,36,811 stating that excess deduction u/s 10A of the Act was provided under the previous order.

Aggrieved, the assessee filed a writ petition before the Hon'ble High Court stating that reopening the case u/s 147 of the Act merely based on change of opinion by the AO and without any changes in material facts of the case was not constitutional. The Hon'ble High Court upheld the assessee's contention and quashed the notice of reopening u/s 148 of the Act and the subsequent order.

Aggrieved, the revenue preferred an appeal before the Hon'ble Supreme Court.

Decision of the Hon'ble Supreme Court:

The Hon'ble Supreme Court held that section 147 of the Act conferred the AO with the power to re-assess the case and not to review the case. In the present case no new facts came to the knowledge of the AO as compared to those considered while framing the original order. Re-opening the case and reassessing the income was merely a case of change in opinion by the AO. However, reopening a case due to a change of opinion was not included in the conditions applicable for subsequent reopening of the case as specified u/s 147 of the Act merely based on change in opinion by the AO and without any changes in material facts of the case was not constitutional. The Hon'ble High Court upheld the assessee's contention and quashed the notice of reopening u/s 148 of the Act and the subsequent order.

Aggrieved, the revenue preferred an appeal before the Hon'ble Supreme Court.

Decision of the Hon'ble Supreme Court:

The Hon'ble Supreme Court held that section 147 of the Act conferred the AO with the power to re-assess the case and not to review the case. In the present case no new facts came to the knowledge of the AO as compared to those considered while framing the original order. Re-opening the case and reassessing the income was merely a case of change in opinion by the AO. However, reopening a case due to a change of opinion was not included in the conditions applicable for subsequent reopening of the case as specified u/s 147 of the Act.

Accordingly, The Hon'ble Supreme Court quashed the notice for reopening and the subsequent order by the AO and upheld the order of the Hon'ble High Court.

RECENT IMPORTANT PRESS RELEASES ISSUED BY THE CENTRAL BOARD OF DIRECT TAXES ('CBDT')

1. Press release dated April 14, 2018 - Requirement for obtaining PAN Card u/s 139A eased for corporate assessees

In case of a company, an application for incorporation, allotment of Permanent Account Number ('PAN') and allotment of Tax Deduction and Collection Account Number ('TAN') may be made through a Common Application Form submitted to the Ministry of Corporate Affairs ('MCA'). In these cases, the \

ertificate of incorporation issued by MCA contains a mention of both PAN and TAN.

The link to visit the press release is provided hereunder:
https://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/705/PressRelease-Requirement-obtaining-PAN-card-139A%20-IT-eased-14-4-2018.pdf

2. Press release dated May 16, 2018 - Double Taxation Agreement between India and Brunei for exchange of information and assistance in collection of taxes.

The Union Cabinet Chaired has approved the signing and ratification of Agreement between India and Brunei Darussalam for the Exchange of Information and Assistance in Collection with respect to Taxes.

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