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.

CASE LAW 1:

Gemstone Glass (P.) Ltd. Vs. DCIT [2018] 100 taxmann.com 5 [TAhd]

A transfer pricing ('TP') adjustment of notional interest for delay in realisation of debts from associated enterprise ('AE') is not required when the international transaction of export of goods has been benchmarked using Transactional Net Margin Method ("TNMM").

Facts of the case:

The assessee, a subsidiary of Trend Group SpA, Italy is a manufacturer of glass mosaic having its manufacturing units in Gujarat. The assessee has AEs in Italy, Malaysia, Hong Kong and USA.

The assessee had benchmarked the international transaction of sale of manufactured products to the AEs by applying TNMM.

In the aforesaid case, it was observed from the invoices raised by the assessee on its AEs that the payment of invoices exceeded the credit period extended to AEs.

The TPO was of the view that a commensurate remuneration/compensation should be charged by the assessee as it was deprived of its own available funds. Thus, the outstanding amount was considered as loan and interest rate was benchmarked on that loan using external comparable uncontrolled price method ('CUP'). The invoices were denominated in United States Dollar and Euro, the receivables pertaining to such invoices were treated as US Dollar and Euro denominated loan extended to the AEs by the assessee.

The assessee contended that the assessee has not charged any interest on delayed payments from the third parties. Also, such short delays in payments are in normal course of business. However, the plea of the assessee was rejected and an upward adjustment for interest was made.

Aggrieved by the order of Revenue authorities, the assessee preferred an appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal held that TNMM method considers all the income and expenditure of the entity and takes the net margin as the profit level indicator. Further, it also takes care of the interest income if any forgone by the assessee on account of late payment received from the associated enterprise. Merely a delay in realization of debts cannot be a reason to make an upward adjustment unless there are facts which indicate that such delay is absent in case of similar transactions with unrelated parties.

When no such transactions have taken place, then there is no basis for comparison. In the present case, assessee has not charged any interest on delayed payments from the third parties.

Therefore, the Hon'ble Tribunal ruled in favour of assessee and deleted the upward ALP adjustment of notional interest charged on delayed payment of dues from the AEs, as the same had not been charged on delayed payments from the third parties.

INTERNATIONAL TAX

CASE LAW 1:

DCIT Vs. Joint Secretary Organizing Committee for Winter Games [2018] 100 taxmann.com 67 [TDel]

Where assessee had entered into consortium agreement with foreign companies, and foreign parties were required to supply equipments only and payments had been made directly to those parties and, title in goods had passed to assessee outside India at port of shipment, no income had accrued to those parties in India and, therefore, provisions of section 195 did not apply to these payments.

Facts of the case:

The assessee was engaged in organizing South Asian Federation Winter Games, 2009 ('the Games') in Uttarakhand and was involved in development of infrastructure facilities such as stadiums, ice skating rink, development of ice skiing slopes, ancillary sports facilities and other infrastructure for the Games. The assessee had entered into a consortium agreement with two foreign companies and one Indian company for rendering services with respect to construction of water storage and installation of ski lift and comprehensive maintenance for three years. The foreign parties were only to supply various equipment and the Indian party was to install those equipment.

The assessing officer ('AO') noted that the assessee had made a payment to foreign party on which no tax was deducted u/s 195 of the Act. Further, the AO contended that the assessee had not deducted tax at source u/s 194C of the Act on payments made to the Indian parties for construction of work as per the consortium contract.

In this regard, the AO calculated the interest on short deduction of TDS and passed the assessment order against the assessee. On appeal, the Hon'ble CIT(A) upheld the order of the AO.

The Hon'ble CIT(A) held that as the payments were made to a consortium and the whole payment was made for the purpose of the work, tax was required to be deducted at source on the payment made, not u/s 195 of the Act but covered u/s 194C of the Act. Accordingly, the Hon'ble CIT(A) directed the AO to compute the shortfall.

Aggrieved by the decision of the Hon'ble CIT(A), cross appeals were filed before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal held that the assessee had raised separate invoices on the foreign company only for supply of equipment, therefore, it was payment for sale of goods. Hence, there was contract for sale and not contract for work.

Reliance was also placed on the Circular No. 7/2016 wherein the conditions were mentioned for the consortium to be treated as an Association of Person ('AOP'). Since the assessee's consortium did not fulfil the conditions, the consortium was not treated as AOP i.e. separate entity. Therefore, all the members of the consortium were independently responsible for execution of work and the foreign parties were required to supply the equipment only along with the warranty.

Further, it was held that the title in the goods have passed from the suppliers to the assessee outside India at the port of shipment and thus, no income had accrued to those parties in India in terms of provisions of section 5 and section 9 of the Act, therefore, provisions of section 195 of the Act does not apply to these payments.

Thus, the assessee was not required to deduct tax at source either u/s 194C of the Act or u/s 195 of the Act on payments made to foreign parties for sale of goods.

DOMESTIC TAX

CASE LAW 1:

ACIT Vs. M/s Celerity Power LLP [ITA No. 3637/Mum/2015]

No capital gain tax on conversion of Co. into LLP if assets/liabilities were transferred at book value.
Various issues of the assessee have been summarized as under:

Issue 1: Whether transfer has taken place at the time of conversion

Facts of the case:

M/s Celerity Power LLP ('the assessee') had acquired the status of LLP with effect from September 28,2010, prior to which it was run by a private limited company viz. M/s Celerity Power Pvt. Ltd. The assessee was of the contention that such a conversion only involved vesting of the assets and liabilities of the private limited company in the successor LLP, and thus did not involve any transfer of the property, assets, liabilities etc. However, the AO disagreed with the said contention, and passed the assessment order accordingly.

Aggrieved by this, the assessee carried the matter to the Hon'ble CIT(A). Based on clause (6) of the Third schedule to the Limited Liability Partnership Act, 2008, the Hon'ble CIT(A) upheld the decision passed by the AO, following which an appeal was preferred before the Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal also upheld the decision of the Hon'ble CIT(A) and passed the decision stating that the conversion of a private limited company into an LLP constituted transfer of the assets and liabilities of the company.

Issue 2: Whether there was any capital gain as a result of such conversion?

Facts of the case:

As per the AO, the benefits availed by the company was deemed as the profits and gains of the successor LLP and should be taxed as capital gains u/s 47(4) of the Act, to which the assessee disagreed. The assessee thus preferred an appeal before the Hon'ble CIT(A).

The Hon'ble CIT(A) agreed with the assessee's contention, claiming that there was an absence of any consideration in the transaction of conversion of the private limited company into a LLP and thus the computation of capital gain contemplated in section 48 of the Act was rendered void, following which the Hon'ble Revenue preferred an appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

If the conditions of section 47(xiiib) of the Act are not satisfied, then the same would imply that the transaction is chargeable to capital gain u/s 45 of the Act. In the case of the assessee, it was observed that the turnover of the erstwhile company in the FY 2009-10 was INR 8,87,08,620. As a result of which clause (e) of section 47(xiiib) of the Act was being violated i.e. the total sales, turnover or gross receipts of the business of the erstwhile company in any of the three previous years preceding the previous year in which the conversion took place was not to exceed INR 60 lakhs. Thus, as per the Hon'ble Tribunal section 45 of the Act would be applicable in the present case. However, since the assets and liabilities are vested in the LLP at the book values itself there would be no capital gain chargeable to tax.

Issue 3: Whether the loss of the private limited company would be carried forward to the LLP?

Facts of the case:

The assessee claimed that the loss of the private limited company should be carried forward to the LLP, which was rejected by the AO as well as the Hon'ble CIT(A). Aggrieved by this, the assessee preferred an appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

As per section 72A(6A) of the Act, where a private limited company is being succeeded by a LLP then the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganization was effected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly. However, for the above section to apply is that the assessee must fulfill the conditions as laid down in section 47(xiiib) of the Act, which in this case has been violated by the assessee. Hence, the same has been not allowed by the Hon'ble Tribunal and the decision of the Hon'ble CIT(A) has been upheld.

Issue 4: Whether deduction u/s 80-IA of the Act will be allowed?

Facts of the case:

The Hon'ble A.O. disallowed the deduction u/s 80-IA of the Act on the grounds that the assessee had failed to file the Audit Report in Form 10CCB along with its return of income. On the contrary, when an appeal was preferred before the Hon'ble CIT(A), the same was allowed based on an additional evidence in the Audit Report in Form No. 10CCB submitted by the assessee and based on the fact that the benefit of the deduction under the relevant section was attached to the undertaking and not to its owner assessee. As a result, the revenue preferred an appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal upheld the decision of the Hon'ble CIT(A) in case of deduction claimed by the assessee u/s 80-IA of the Act.

CASE LAW 2:

M/s Jupiter Capital Pvt. Ltd. Vs. ACIT [ITA No. 445/ Bang/2018]

Reduction of share capital of a company by way reducing the number of shares amounts to "extinguishment of rights" and is a "transfer" u/s 2(47) of the Act. The assessee is eligible to claim a capital loss therefrom.

Facts of the case:

In the present case, the assessee had invested an amount of INR 1,22,24,41,300 in the shares of M/s Asianet News Pvt. Ltd. ('ANNPL') having face value of INR 10.

However, since the company was incurring deep loses, the company filed a petition with the Hon'ble High Court for reduction of share capital to set off the losses internally, which was duly approved by the Hon'ble High court as well, wherein the number of shares of the assessee were reduced to 9,988 from 15,33,40,900 shares previously held by the assessee amounting to 99.88% keeping the face value constant at INR 10. In return the assessee received a consideration of INR 3,17,83,474 from ANNPL.

The assessee claimed the balance amount reduced in share capital amounting to net INR 1,64,48,55,840 after subtracting the consideration received from the indexed cost of acquisition of the relative shares as long-term capital loss while filing its return of income.

However, the AO disallowed the same and added it back into the income of the assessee stating that since the face value and percentage of holding of the assessee in ANNPL remained the same after the scheme of reduction of share capital, the said amount is outside the purview of section 2(47) of the Act and does not amount to relinquishment of right in a capital asset as per the provisions of the said section.

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

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal held that on account of reduction in number of shares held by the assessee company in ANNPL, the assessee has extinguished its right of 153340900 shares and in lieu thereof, the assessee received 9988 shares at INR 10/- each along with an amount of INR 3,17,83,474/-. Thus, it was held that this amounts to transfer in view of the provisions of section 2(47) of IT Act. As per the judgment of Hon'ble Apex Court rendered in the case of Kartikeya V. Sarabhai Vs. CIT (supra), there is no reference to the percentage of share-holding prior to reduction of share capital and after reduction of share capital and hence, the basis adopted by the CIT(A) to hold that this judgment of Hon'ble Apex Court is not applicable in the present case is not proper and in our considered opinion, this is not proper.

Thus, the assessee's claim for capital loss on account of reduction in share capital in ANNPL is allowable.

CASE LAW 3:

FIS Global Business Solutions India Pvt Ltd Vs. PCIT (WP(C) 12277/2018, CM APPL 47539/2018)

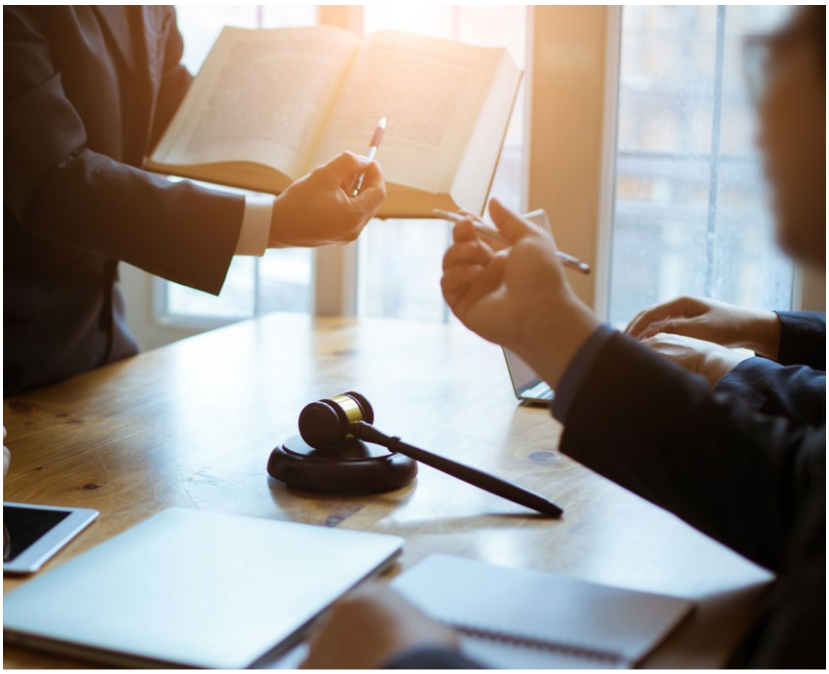
No case can be opened for reassessment after four years from the end of the relevant assessment year only on the basis of revenue audit objection as the same is not tangible material but is mere information.

Facts of the case:

The assessee company was engaged in business of software development and outsourcing services. The assessee was selected for assessment and an order u/s 143(3) of the Act was passed. Subsequently, the AO received an audit objection in which it was stated that certain expenses of capital nature were claimed as expenses. Thus, the AO issued a notice u/s 148 of the Act for reopening the case for reassessment u/s 147 of the Act after four years from the end of the relevant assessment year. The same was done by the AO by invoking the first proviso to section 147 of the Act which states that if the AO has reason to believe that income for the year under consideration has escaped assessment due to failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment, action u/s 147 of the Act can be taken even after expiry of four year from the end of the relevant assessment year.

However, the assessee contended that the revenue was revisiting the merits of the original scrutiny assessment which was time barred. The assessee relied on the case of Carlton Overseas Pvt. Ltd. Vs. ITO (2009) 318 ITR 295 and Torrent Power S.E.C. Ltd. Vs. ACIT (2017) 392 ITR 330 (Guj), to contend that the rulings in CIT Vs. Kelvinator of India Ltd., 320 ITR 561 authorizes review of the completed scrutiny only and only if there is tangible material to come to the conclusion that income has escaped assessment. It is emphasized that these rulings of Carlton and Torrent (supra) have stated that a subsequent audit objection or audit reports of the Income Tax Department does not constitute objective material.

Accordingly, the assessee filed a writ petition before the Hon'ble Delhi High court against reopening of the case.



CASE LAW 4:

Mr. N.R. Ravikrishnan Vs. ACIT [ITA No.2348/Bang/2018]

Decision of the Hon'ble Tribunal:

The Hon'ble High Court held that the issue in the present case is concluded by the decision of the Hon'ble Delhi High Court in the case of Carlton Overseas Pvt. Ltd. Vs. Income Tax officer & Ors. (supra) that an audit objection is merely information and further, as per the Hon'ble Supreme Court in the case of CIT Vs. Kelvinator of India Ltd.(supra), action u/s 147 of the Act due to a change of opinion is impermissible.

Thus, the Hon'ble High Court held that the impugned re-assessment notice cannot be sustained and resultantly decided in the favor of the assessee.

The date of granting of option under the employee stock option plan ('ESOP') is to be considered as the date of acquisition if the options are sold before the date of vesting.

Facts of the case:

The assessee, an employee of Infosys BPO Ltd. during the assessment year ('AY') 2007-08 filed his income tax return declaring a total income of INR 25,03,015, which included long term capital gains ('LTCG') amounting to INR 20,41,672/-. The case was selected for scrutiny and the assessment was completed u/s 143(3) of the Act.

The assessee had been granted 6,000 ESOP options of Infosys Technologies Ltd. by his employer, Infosys BPO Ltd. These 6,000 options comprised of 1,250 options granted on February 28, 2003, 2,500 options granted on February 02, 2004 and 2,250 options were granted on June 01, 2005. The said options were transferred to/ bought back by Infosys Technologies Ltd., with Infosys BPO Ltd as a confirming party, subsequently vide option transfer agreement dated February 07, 2007.

Thus, transfer of 3,750 options was considered as LTCG and the balance 2,250 options as short term capital gains ('STCG') by the assessee since, the holding period of 3,750 options was more than 3 years.

During the course of the assessment proceedings, the AO alleged that options have no value without exercise of rights. Further, when the options have been granted to the assessee and the assessee has derived gains through transfer, the said transfer essentially represents the exercise of the rights by the assessee. Thus, the AO treated the LTCG arising on transfer of ESOP options as STCG and consequently the deduction u/s 54EC of the Act was denied.

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

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

Decision of the Hon'ble Tribunal:

The Hon'ble Bangalore Tribunal observed the following:

- The options have been sold to Infosys Technologies Ltd. without any exercise of the option;
- If the options had been exercised, and the shares allotted thereby would have been sold after their allotment, then undisputedly the gains arising therefrom would have to be treated as STCG. In the present case, however, the 3,750 options have been transferred as such, without any exercise of options. In the absence of exercise of options, no shares were allotted to the assessee;
- The above is a case of buy back of options by Infosys Technologies Ltd;
- It is not in dispute that options provided valuable right to the assessee to exercise and to have shares allotted to him. They were thus, a 'capital asset' held by the assessee from the date of grant i.e., from February 28, 2003 and February 02, 2004 for which a consideration was paid to the assessee under the option transfer agreement.
- The contention of the AO that the assessee cannot exercise option in the absence of vesting is not relevant as the options were transferred without any exercise in the present case.
- The assessee had also claimed deduction u/s 54EC of the Act and the Hon'ble Tribunal held that the claim of deduction u/s 54EC of the Act is to be allowed since the AO's order mentioned that requisite proofs were provided by the assessee for the purpose of claiming the deduction.

Therefore, the Hon'ble Tribunal held that the date of granting of options is to be considered as the date of acquisition for calculating the capital gain when the options are sold before exercising the options, and hence ruled in favour of the assessee.

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

1. PRESS RELEASE DATED NOVEMBER 26, 2018: PROTOCOL AMENDING INDIA-CHINA DTAA

The Government of the Republic of India and the Government of the People's Republic of China have amended the Double Taxation Avoidance Agreement ('DTAA') for the avoidance of double taxation and for the prevention of fiscal evasion with respect to taxes on income, in line with reports of Base Erosion & Profit Shifting ('BEPS') recommendations, by signing a Protocol on November 26, 2018.

A link for the above press release is provided herewith:
https://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/738/Press-Release-Protocol-amending-India-China-DTAA-26-11-2018.pdf

2. NOTIFICATION NO. 06/2018 [F. NO. PRO DGIT(S)/CPC(TDS)/NOTIFICATION/2018-19], DATED DECEMBER 06, 2018

In exercise of the powers delegated by the CBDT under sub-rule (5) of Rule 31A of the Income-tax Rules, 1962, the Principal Director General of Income-tax (Systems) clarifies by way of this notification that no tax deduction at source under section 194A shall be made in the case of Senior Citizens where the amount of such income or, the aggregate of the amounts of such income credited or paid during the financial year does not exceed fifty thousand rupees, in accordance with the third proviso to section 194A(3) of the Act

A link for the same is provided herewith:
https://www.incometaxindia.gov.in/communications/notification/notification6_2018_tds.pdf

KNAV

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