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DIRECT TAX REVIEW

NOVEMBER 2020


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HIGH COURT RULINGS

Taxability of cashless exercise of stock option under the head Capital gains

Facts

The assessee being a software engineer employed with an Indian company between the period from 1995-98. He was deputed to US as

an independent consultant for a period between 2001-04. The assessee thereafter returned to India and was employed here. While on deputation to US, the assessee was granted stock option where the assessee was given the right to purchase 30,000 shares at an exercise price of US$ 0.08 per share. The assessee in AY 2006-07 exercised his rights under stock option plan by way of cashless exercise and received a net consideration of US $ 2.83 lacs and offered the LTCG to tax. The Ld. AO at the time of assessment brought to tax the difference between the market price on the date of exercise and the exercise price under the head 'income from salary' and the difference between the sale price and the market value on the date of exercise of income from Short term capital gain and disallowed the claim for deduction under section 54F. CIT-A also dismissed the appeal. Further, ITAT also upheld the order passed by the CIT-A. Assessee thereafter approached HC.

Ruling

HC in the given case observed that the assessee was an independent consultant to the US Co. and was not an employee and stated that "there was no relationship of employer and employee between the SiRF USA and the assessee and therefore, the finding recorded by the tribunal is incorrect and states that unless the relationship of employer and employee exists, the income cannot be treated as salary". HC relies on SC ruling in Dhun Daabhoy Kapadia and Hari Brothers P Ltd. and held that "the stock option being a right to purchase the shares underlying the options is a capital asset and concludes that the cashless exercise of option was a transfer of capital asset by way of a relinquishment/extinguishment of right in capital asset in terms of Section 2(47) of the Act, and further rejects ITAT's reliance on Special Bench ruling in Sumit Bhattacharya and passed an order in favour of the assessee.

Source: HC, Karnataka in Chittharanjan A. Dasanncharya vs. CIT; ITA No. 153 of 2014, dated Nov 9, 2020

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Discount on issue of ESOP- allowed as deduction under section 37(1)

Facts

The assessee is a company engaged in the business of manufacture of

Enzymes and Pharmaceuticals ingredients. The case was selected for scrutiny and the AO held that assessee has floated a scheme viz. ESOP and under the scheme had constituted the trust wherein the shares of the company were transferred to trust at the face value and the discount (i.e. the difference of the market price and allotment price) was claimed as an expense under section 37. The AO rejected the claim on the ground that no expense has been crystallized and this being contingent in nature cannot be claimed under section 37. It was also urged that the shares are not handed over to the employees and the said exercise is liable for termination in any situation. The appeal preferred before the CIT-A by the assessee was also dismissed. The assessee further approached ITAT who referred the case to a special bench.

Ruling

In the given case of the assessee, the special bench held that difference in the market value and the face value at which shares were allotted is part of remuneration which is to be paid to the employees in order to compensate them for the continuity of their services to the company and therefore allowable as an expenditure under section 37 of the Income-tax Act, 1961. The appeal was therefore decided in favour of the assessee.

Source: HC, Karnataka in CIT, LTU vs. Biocon Ltd.; ITA No. 653 of 2013, dated Nov 11, 2020

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Manpower supply business through electronic database eligible for Sec. 10A deduction

Facts

The assessee is a private limited company engaged in the business of software development and professional services. The assessee claimed deduction under section 10A in respect of five units out of the six units held by it. The AO by an order re-computed the deduction by reducing the recruitment fee from the export turnover. The assessee filed an appeal before CIT-A and held that the income from human resource services is not eligible for deduction under section 10A and accepted the alternative plea to tax only net income from the business of manpower supply. The assessee thereupon approached ITAT placed reliance on CIT and ANR. Vs. M/s Tata Elxsi Ltd. and ANR and held that the findings recorded by the tribunal is erroneous and requires re-adjudication and accordingly the order for appeal preferred by the assessee was passed in the favour of the assessee. Revenue further approached High Court.

Ruling

In the instant case, HC dismissed Revenue's appeal stating the undermentioned observations and facts:

- the assessee engaged in the business of providing human resource services through a computerized electronic database of qualified personnel is eligible for deduction under section 10A.
- Exp. 2 to Sec. 10A covers 'customized electronic data' and 'services of similar nature notified by the board' under the definition of 'computer software'.
- Also placed reliance on CBDT notification dated 26-09-2000 clarifying the scope of ITeS service for section 10A eligibility stating that, "the notification has been issued with an object to outsourcing service industry in India as it generates employment and helps in earning Foreign Exchange".

HC while rejecting the Revenue's contention concludes that irrespective of the nature of training expenses, assessee's business of transmitting data of qualified personnel, electronically, from its database would fall under 'human resource services' as per CBDT notification granting eligible deduction under section 10A.

Source: HC, Kanarkata in CIT vs. M/s NTT Data Global Advisory; ITA No. 544 of 2013, dated Nov 12, 2020.

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Third Party Administrator is required to deduct TDS on payments made to hospitals u/s 194J of the Income Tax Act, 1961

Facts

The assessee is a JV holding a separate PAN and having status of an AOP declaring gross business receipts in respect of work contracts

carried out by it and tax was duly deducted in accordance with law. The assessee instead of distributing the net profit had directly distributed the business receipts amongst its constituent members in the so-called participation ratio. The AO was of the view that an AOP is a 'person' and in terms of section 4 of the Act, income tax shall be charged on the total income of 'every person' and the expression includes inter alia, a firm and an AOP or a BOI and accordingly finalized the assessment under section 143(3) of the Act treating the assessee as an AOP and making addition of INR. 8.72 crores for AY 2009-10 and INR 10.17 crores in AY 2008-09.

Being aggrieved, the assessee preferred an appeal before the CIT-A who was of the view that though the responsibility of completing the work awarded under the tender was of the respondent, but the actual work was sub-contracted to one of the JV partners and such kind of arrangement is not to be disbelieved and therefore allowed the appeal of the assessee and deleted the addition made by the AO. Revenue carried the matter in appeal before the Tribunal but did not succeed who placed reliance on the CBDT Circular No.7/2016 whereby it has been clarified that there will not be any tax liability on the income of the joint venture if the same income has been offered to tax by the members of the joint venture. Revenue further approached the HC.

Ruling

HC held that having regard to the concurrent findings recorded by ITAT after taking into consideration the material on record, it is held that order passed by the ITAT does not suffers from legal infirmity and hence appeal stands dismissed.

Source: HC, Ahmedabad in PCIT vs. M/s Backbone Projects Ltd.; R Tax Appeal no. 702 of 2019 dated Nov 20, 2020.

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ITAT RULINGS

Unabsorbed depreciation of dissolved firm allowable to successor Proprietorship

Facts

The assessee was a partner in the firm which had five other partners that retired from the firm with their capital accounts leaving the

capital assets of the firm undistributed and the case of the individual assessee left behind was selected for scrutiny wherein several information was called for by the department and was assessed with a higher income. The PCIT observed and raised several queries on Unabsorbed depreciation and held that the Assessment Order is erroneous and prejudicial to the interest of the Revenue and accordingly invoked the provisions of Section 263 and issued a notice under section 264 of the Act. The PCIT further claimed that how Unabsorbed depreciation of INR. 5.47 crores claimed by the assessee was allowed for AY 2013-14, even though the assessee was having taxable income for the AY 2011-12 and 2012-13.

The PCIT also held that the loss of the erstwhile firm is not allowable against the income of the individual who succeeded to the business of erstwhile firm and observed that as per the provisions of section 10(2A) of the Act, the share of profit of a partner in a firm is exempt from tax and so also conversely, the share of loss of a partner is exempt from tax. Further, observed that there is no provision in the Act for allowing the carry forward loss of a dissolved firm in the hands of an individual and therefore, the assesssee's claim of setting off of unabsorbed depreciation of the dissolved firm is not allowable. The PCIT further took reliance on the provisions of section 78(1) and held that only the firm is entitled to the set off of business loss and if there is a change in the constitution of the firm, the set off is not to be allowed. The assessee further filed an appeal before the ITAT.

Ruling

ITAT held that the Ld. PCIT has misconstrued that the assessee has set off the carried forward business loss from the income of the individual and relied upon the SC ruling in the case of A. Dharma Reddy stating "where a partnership was dissolved, but the assessee either individually or along with some other partners continue to carry on the same business, the assessee will be entitled to set off his share of unabsorbed loss from the firm against his business income from the AY. ITAT further placed reliance upon Madras HC ruling in N. Krishnammal on Sec. 32(2) wherein it was held that the unabsorbed depreciation becomes the depreciation of the current year of the business and the same is eligible for set off against the individual income of the assessee under section 170 of the Act as he is the successor to the business. Further, the Ld. PCIT accepts assessee's stand that the conversion of firm into a proprietary concern was legally valid because the duration of the firm was AT WILL, and since the assessee continued the business of the firm as a successor in business in his individual capacity, the unabsorbed business loss or depreciation of the erstwhile firm is to be allowed to be carried forward in his individual assessment in terms of Sec. 170.

Source: ITAT, Hyderabad Bench 'A' in Yerram Venkata Subba vs. ACIT, Hyderabad; ITA No. 1119 of 2018, dated Nov. 4, 2020

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Mandatorily set-off of prior years' losses under section 72 allowable via rectification application

Facts

The assessee is a private limited company engaged in the business of software development. The total income comprised of business income of `NIL' which has arrived after claiming deduction under section 10A of the Income-tax Act and set off of earlier years losses and Income from other sources. The assessee had inadvertently omitted to set off earlier years unabsorbed depreciation with the income of other sources. The deduction under section 10A was restricted to INR. 40.89 lacs as against the claim of INR. 41.75. The assessee filed a rectification application. The rectification order was passed restricting the benefit of set off of brought forward losses only to the business income and not income from other sources. Assessee also preferred an appeal before the CIT-A who held that since the set off of brought forward losses/unabsorbed depreciation was not the subject matter of the decision by the appellate authority and upheld the decision of the AO. CIT(A) also held that though the assessee has filed an application u/s 154 praying for set off of unabsorbed business losses/ depreciation

against the total income, the assessee ought to have pursued the rectification application. Aggrieved by the order, the assessee filed an appeal before the ITAT.

Ruling

ITAT in the case of the given assessee holds that the business loss and unabsorbed depreciation of earlier years which ought to have been set off against the business income remaining after claiming deduction under section 10A against the Income from other sources stating that Revenue cannot reject the plea for rectification under section 154 merely on the grounds that assessee omitted to claim set-off while filing its original return of income and are required to give effect to section 72(1)(i) and set off such losses. ITAT also placed reliance upon CBDT Circular No. 14 dt. 11 April, 1955 followed by the Karnataka HC ruling in Wipro Limited held that it is mandatory to set off of business loss with business income of a subsequent year.

Source: ITAT, Bangalore Bench 'A' in M/s. Mistral Solutions Pvt. Ltd. vs. DCIT, Bangalore; ITA Nos. 1911-1914 from AY 2005-06 to AY 2008-09, dated Nov. 9, 2020

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Loss on account of foreign currency fluctuation can be claimed as revenue expenditure

Facts

The appellant is a 100% subsidiary of a UK based company engaged in the business of development of designs and drawings, manufacture mechanical seals and sealing systems. The case of the assessee was selected for scrutiny wherein the Ld. AO had disallowed the revenue expenditure claimed by the assessee for allowance of loss of INR. 1.54 lacs on account of fluctuation in the foreign exchange rate on External Commercial Borrowing loan taken for acquisition of assets in India. The Ld. AO placed reliance on the decision of the Hon'ble SC in the case of CIT vs. Tata Iron & Steel Ltd., 231 ITR 285 (SC) and Sullej Cotton Mills vs. CIT, 116 ITR 1 and held that in the absence of specific legal provisions, forex loss could not allowed as revenue expenditure nor could it be added to the actual cost of the asset acquired. Assessee further filed an appeal before the ITAT.

Ruling

ITAT observed that the loan was availed for acquiring assets in India while Sec. 43A of the Income-tax Act is applicable only in case of imported assets. Taking into consideration the facts in the present case, ITAT also states that the assets were acquired in India, therefore, the conditions of making actual repayment of foreign currency loan as stipulated under Sec.43A is not a condition for making necessary adjustment in the actual cost of the asset and hence general principles of law would be applicable. Further, ITAT also relies on SC ruling in Arvind Mills Ltd. where on the general principles SC ruled that the increased liability should be taken as 'actual cost' and held that 'the necessary adjustments should be made to the actual cost of assets on account of loss consequent to foreign currency fluctuation rate as there is no dispute that ECB loans are utilized for the purpose of acquisition of asset in India' and the appeal was accordingly decided in favour of the assessee.

Source: ITAT, Pune Bench 'B' in Aesseal India Pvt. Ltd. vs. ITO, Pune; ITA No. 2202 & 2203/PUN/2017, dated Nov. 25, 2020

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Allowability of expenditure on exhibition of movies through audio and TV under rule 9A(3)

Facts

The assessee is engaged in the business of production of feature films. The assessee had produced, released and exhibited a feature film in Kannada language on commercial basis in certain areas. He also sold audio and TV rights of the film and computed his income from business as per Rule 9A(3)(c) of I.T. Rules, which permitted to set off the expenditure on production of film against gross receipts on exhibition of film on commercial basis. Accordingly, the assessee set off the production expenditure against gross receipts and carried forward remaining unclaimed expenditure of INR. 3.79 crores to next year. In the instant case, the AO noticed that the assessee did not sell rights of exhibition of film in any area and has included the receipts from sale of audio rights and T.V. rights also in computing the amount realised from exhibition or sale of rights of exhibition. The AO took the view that the expression "amount realised from exhibition of film on a commercial basis" used in Rule 9A(3)(c) should not be construed to include all receipts from film such as sale of audio rights, T.V. rights.

Furthermore, AO stated that rule 9A(3)(c) uses the phrase "himself exhibits film on a commercial basis in certain areas and sell the rights of exhibition of the film in respect of all or some of the remaining areas" and emphasized the word "areas" used in rule 9A(3)(c) and accordingly expressed that the rules talks about the different geographical regions and not through different mediums and accordingly held that the amount of INR. 5.75 crores received by the assessee on sale of audio rights and TV rights cannot be included in the category of "receipts from exhibition of films". Thereafter, assessee preferred an appeal before the Ld. CIT-A which confirmed the order passed by AO. Assessee is in appeal before ITAT.

Ruling

ITAT, in the given case allows assessee's appeal against disallowance of expenditure to a film distributor on exhibition of films via audio and TV and held that rule 9A(3)(c) covering the modern media like TV, OTT, and audio within the ambit of "areas". ITAT further states that the primary importance should be given to the expression 'exhibition of film on a commercial basis' and relied on SC ruling in Laxmi Video Theatres where expenditure incurred in exhibition of films via VCR/VCP was allowed to the assessee.

Source: ITAT, Bangalore Bench 'B' in Shri Vijaykumar Thimmegowda vs. ITO, Bangalore; ITA No. 2928/Bang/2017, dated Nov. 10, 2020

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Deletion of the entire disallowance made under section 14A read with rule 8D if the interest free funds available with the assessee is more than the investments which had actually yielded exempt income

Facts

The assessee had earned and claimed dividend income of INR. 1.54 crore during the year as exempt and had suo moto made

disallowance of INR. 0.80 crores under section 14A of the Act at the time of filing its ROI. The AO enhanced the dis-allowance by INR. 2.93 crores under rule 8D(2)(ii). The assessee pleaded before the Ld. CITA that it had sufficient own funds and hence there cannot be any disallowance of any interest under the second limb of Rule 8D(2) of the Rules. It also pleaded that only those investments which had actually yielded exempt income should be considered for considering the disallowance under second and third limb of Rule 8D(2) of the Rules. Aggrieved, both the assessee as well as the revenue are in appeal before ITAT.

- The revenue is in appeal against the action of the Ld. CIT-A deleting the interest disallowance made under second limb of Rule 8D(2) of the Rules over and above the disallowance made by the assessee voluntarily in the return.
- The assessee is in appeal against the interest disallowance of INR. 7.35 lacs upheld by the Ld. CIT-A (though voluntarily made by the assessee in the return) under second limb of Rule 8D(2) of the Rules; even if it is to be made, on without prejudice basis, only the net interest should be considered for such disallowance and that only those investments which had actually yielded exempt income should be considered for working out the disallowance under second and third limb of Rule 8D(2) of the Rules.

Ruling

ITAT in the given case directed the Ld. AO to delete the disallowance of interest to the extent of INR. 3 crores (including disallowance of INR. 7.35 lacs voluntarily made by the assessee in the return) under Rule 8D(2) pointing out "if the interest free funds available with the assessee is more than the investments which had actually yielded exempt income, then the general presumption that such investments were made out of interest free funds and not out of borrowed funds, would prevail". ITAT also held that there cannot be any disallowance of interest under Rule 8D(2), even though the same was erroneously made by the assessee in the return of income, once sufficient own funds are available with the assessee for making investments.

Further, with regard to disallowance of indirect expenses under Rule 8D(2)(iii), ITAT placed reliance on Special Bench ruling in Vireet Investments and held that for working out the disallowance, only those investments are to be considered which had actually yielded exempt income and directs Revenue to further reduce the disallowance under Rule 8D(2)(iii) already made by the assessee.

Source: ITAT, Mumbai Bench 'G' in DCIT vs. M/s Godrej Properties Limited; ITA No. 6486/MUM/ 2018, dated Nov 27, 2020.

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CIRCULARS & NOTIFICATIONS

Audit report to be filed by the Sovereign Wealth Fund claiming exemption under clause (23FE) of section 10 of the Income -tax Act, 1961

The CG hereby specifies that the investments in the sovereign wealth fund, namely, the MIC Redwood 1 RSC Limited by the specified persons shall be eligible for exemption subject to the fulfilment of the following conditions by the assessee, namely:

- File ROI, for all the relevant previous years falling within the period beginning from the date in which the said investment has been made and ending on the date on which such investment is liquidated, on or before the due date specified for furnishing the return of income under sub-section (1) of section 139 of the Act;
- Get its books of account audited for the previous years referred to in clause (i) by any accountant specified in the Explanation below sub-section (2) of section 288 of the Act and furnish the Audit

Report in the format annexed as Annexure to this notification herewith at least one month prior to the due date specified for furnishing the return of income under subsection (1) of section 139 of the Act.

- Furnish a quarterly statement within one month from the end of each quarter electronically in Form II as annexed to the Circular No 15 of 2020, dated the 22nd July, 2020 with F. No. 370142/26/ 2020-TPL, made by it during the said quarter;
- Maintain a segmented account of income and expenditure in respect of such investment which qualifies for exemption under clause (23FE) of section 10 of the Act;
- Continue to be owned and controlled, directly or indirectly, by the Government of the Abu Dhabi and at no point of time any other person should have any ownership or control, directly or indirectly, in the assessee;
- Continue to be regulated under the law of the Government of Abu Dhabi;
- The earnings of the assessee shall be credited either to the account of the Government of Abu Dhabi or to any other account designated by that Government so that no portion of the earnings inures to any private person;
- (a) does not and shall not have any loan, borrowing, advances, deposits or investment in it of any kind directly or indirectly from any person other than the Government of the Abu Dhabi; (b) shall only invest the surplus fund of the Government of Abu Dhabi and that Government shall not raise any loan, debt etc. directly or indirectly, from the market or any entity to make the said investment;
- the asset of the assessee shall vest in the Government of Abu Dhabi upon dissolution;
- Does not and shall not undertake any commercial activity whether within or outside India other than the said investment or investment of similar nature;
- Have monitoring mechanism to protect the said investment with investee but shall not manage day to day operations of the investee or appoint executive directors in the investee company or participate in the decision-making process or control them;
- Not carry out asset management activity for any person other than itself.

Source: Notification No. 89/2020 dated Nov 2, 2020.

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Condonation of delay in filing of Form No. 10BB for Assessment Year 2016-17 and subsequent years

As per the provisions of section 10(23C) of Income-tax Act, 1961 where the total income, of the fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv), (v), (vi) and (via),

without giving effect to the provisions of the said sub-clauses, exceeds the maximum amount which is not chargeable to tax in any previous year, such trust or institution hall get its accounts audited in respect of that year by an accountant as defined in the Explanation below sub-section (2) of section 288 before the specified date referred to in section 44AB and furnish by that date, the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed

With a view to expedite the disposal of applications filed by such entities for condoning the delay and in exercise of the powers conferred under section I 19(2) (b) of the Act, the CBDT hereby directs that:

- In all the cases of belated applications in filing of Form No. 10BB for years prior to AY. 2018-19, the CIT are authorized to admit such applications for condonation of delay uls 119(2)(b) of the Act and shall satisfy themselves that the applicant was prevented by reasonable cause from filing such application within the stipulated time. Further, all such applications shall be disposed of by 31-03-2021.
- Where there is delay of up to 365 days in filing Form No. lOBB for AY 2018-19 or for any subsequent AY, the CITs are hereby authorized to admit such belated applications of condonation of delay under section 119(2) of the Income-tax Act, 1961 and decide on merits.

Source: Circular No. 19/2020 dated Nov 3, 2020.

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ITAT RULINGS

When India does not have any taxation right on a shipping income of non-resident entity, exemption or reduced rate of taxation in the source state is of no relevance because once the taxing right has been given off, the other conditions like exemption or reduced rate of tax has no bearing on the taxability of particular income in other Contracting State.

Facts

The assessee is a resident of Singapore and involved in the business of operation of ships in International Traffic. The assessee was the freight beneficiary in respect of various vessels which sailed from ports in the Indian sub-continent and South East Asia during the financial year 2014-15. The assessee claimed exemption from tax on income received from shipping operations in India in pursuant to the India-Singapore tax treaty on the ground that as per Article 8 of India-Singapore DTAA, tax resident of Singapore involved in the operations of ships in international traffic, is assessable to tax in Singapore on global income received [including income earned in India] from its shipping business. Since, the income of the assessee from its shipping operations is exempt u/s 13F of the Singapore Income Tax Act, the Assessing Officer was of the opinion that the benefit of Article 8 of India Singapore DTAA is not applicable to the assessee because of specific restriction provided under Article 24 of India Singapore DTAA and accordingly made additions to the returned income of the assessee.

Ruling

The Tribunal held that there was no dispute to the fact that the assessee is a tax resident of Singapore and does not have a PE in India. Undisputedly, the activities carried out by the assessee in India are covered under Article 8 of India Singapore DTAA. As per Article 8 of India Singapore DTAA, the profits derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State. Therefore, by virtue of Article 8 of India Singapore DTAA, the international shipping income of a resident of a Contracting State is taxable only in that State i.e., the shipping income of a Singaporean resident by the operations of ships in international waters is taxable only in Singapore on accrual basis.

Similarly, Article 24 of India Singapore DTAA limits the relief on the basis of income from sources in a Contracting State is exempt from tax or taxed at a reduced rate in that Contracting State and under the laws in force in the other Contracting State, the said income is subject to tax by reference to the amount thereof which is remitted to or received in that other Contracting State and not by reference to the full amount thereof, then the exemption or reduction of tax to be allowed under this agreement in the first-mentioned Contracting State shall apply to so much of the income as is remitted to or received in that other contracting State. From the combined reading of Articles 8 and 24 of India –Singapore DTAA, it is very clear that article 8 provides exclusive right of taxation to country of residence, i.e. Singapore on accrual basis.

Similarly, article 24 limits the exemption, in case income is exempt or taxed at reduced rate in source country, i.e. in India and further such income is taxable in country of residence on receipt basis. The AO, referring to Article 24 of the tax treaty, believed although global shipping income of a Singapore tax resident is taxable only at resident State, but by virtue of Article 24 exemption would apply only to the extent of the amount repatriated / remitted to Singapore.

As may be seen from the provisions of Article 8(1), it is not an exemption provision but an enabling provision which provides an exclusive right of taxation of income to the residence country. Further, by entering in to treaty with Singapore, India has given up its right to tax shipping income of a non-resident in India. Therefore, any income of a non-resident shipping company which is a tax resident of Singapore is liable to tax only in Singapore but not in India. Exclusive right of taxation in one Contracting State is not the same as the

specific exemption being available in other Contracting State. When India does not have any taxation right on a shipping income of non-resident entity, exemption or reduced rate of taxation in the source state is of no relevance because once the taxing right has been given off, the other conditions like exemption or reduced rate of tax has no bearing on the taxability of particular income in other Contracting State. The Tribunal directed the Assessing Officer to delete the additions made towards shipping income of assessee earned in India.

Source: ITAT, Chennai in Bengal Tiger Line Pvt. Ltd., vs. DCIT
ITA No. 11 of 2020, dated Nov 6, 2020

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A large comparable cannot be used to determine ALP of an international transaction

Facts

Assessee is a company wherein 99.99% of the shareholding is held by a Mauritius parent and 0.01% by a US company. It is engaged in providing medical transcription services to its associated enterprise and had centers in Bangalore and Delhi. It has responsibility for transcribing medical data and information services. During the previous year assessee provided back office medical transcription services to its associated enterprise at the markup of 22.18% on total operating cost. The case of the assessee was picked up for scrutiny and the international transactions were referred to the learned Transfer Pricing Officer for determining arm's-length price. The assessee benchmarked its transaction using Transactional Net Margin Method as the Most Appropriate Method using Operating Profit/Total Cost as the Profit Level Indicator selecting six comparable companies where their average margin was 11.86% using the multiple year data, assessee computed its own margin at 22.19% and stated that its international transactions are at arm's-length.

The learned Transfer Pricing Officer examined the transfer pricing study report of the assessee, issued show cause notice challenging the benchmarking analysis and accept / reject metrics along with filters used by the assessee. TPO proposed new filters using single year data (current year data), proposed to reject all five other comparables only retaining one comparable i.e. cosmic global Ltd. After considering the submissions of the assessee, learned transfer pricing officer selected five other comparable whose average margin was 33.83% using single year data and determined arm's length price of the international transactions and proposed an adjustment u/s 92CA, wherein he included functionally similar, but large comparables having turnovers significantly higher than that of the assessee.

Ruling

The Tribunal cited the ruling in 381 ITR 216 CIT versus Pentair Water Ltd by the Honorable Bombay High Court, where it was held that a comparable company having a turnover of Rs 260 crores (HCL Commet Ltd] cannot be compared with the assessee having only Rs. 11 crores turnover. Thus, exclusion of the comparable which is having turnover 23 times of the assessee was upheld by that Court. Here the Tribunal was pitched to compare a comparable which is having turnover 26 times larger than the assessee. Therefore, on this ground, the Tribunal accepted the argument of the assessee that such a large comparable could not be used to determine ALP of an international transaction of the assessee.

Therefore, respectfully following the criteria laid down by the honorable Bombay High Court, we direct the learned transfer pricing officer to exclude I gate global Ltd. Similarly, Infosys BPO Ltd, which is having the turnover more than 31.29 times, and TCS E serve Ltd having turnover of 62 times larger than the assessee does, were also to be excluded from the comparability analysis.

Source: ITAT, Delhi in Transcend MT Services Pvt. Ltd. vs. DCIT

ITA No. 2229 of 2015, dated Nov 8, 2020

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Where salary did not accrue or arise in India, the same was not chargeable to tax and withholding tax provisions were inapplicable

Facts

The assessee is a company registered in Netherlands and it has established a project office in India after it was awarded the contract with Punjab Road and Bridges Development Board in the financial year 2009-10. It filed its return of income at loss and claimed refund from its operations of project office situated in Chandigarh, India. During assessment proceedings, the AO noted that assessee has claimed an amount of Rs. 73,17,159/- as salary expenses and assessee has not deducted tax on the same, and made corresponding disallowances thereon.

Ruling

In Mother Dairy Fruit Vegetable Private Ltd. vs. CIT Delhi, High Court held that to cover case under this provision it is necessary for department to establish that the employees to whom the said salaries were paid have received their income, either on actual or deemed basis in India or the income in question accrues or arises in India either on actual basis or deemed basis. The non-residents who never worked in India, never received salary from permanent establishment; were non-residents and were paid their remuneration in foreign exchange in a foreign country, would not be required to pay any tax in India as provision of Section 5 would not apply. This conclusion would be clear from the reading of Section 9(1)(ii). Salary payment can be said to be earned in India only if the corresponding services are rendered in India. In other words, if the services are rendered outside India, for which salary has been paid, then the income cannot be said to accrue or arise in India. Further, since in the instant case services are rendered outside India in respect of which the employees received salary outside India, it cannot be said that the same accrue or arise in India.

Where the assessee had worked outside the India, he received salary outside India from an Indian employer namely Shipping Corporation of India, the Bombay High Court on these facts held that since the place where the services are rendered is relevant for determining chargeability of the tax, no tax would be payable on the salary received on the services rendered outside India.

Since the facts of the instant case are identical to the facts of the case

decided by the Delhi High Court, therefore, respectfully following the said decision assessee is not liable to deduct tax at source from the salary paid to the non-resident and has not committed any default in not deducting tax at source from the reimbursement to the head office on account of salary expenses. Accordingly, the order of the CIT(A) is set aside and the grounds raised by the assessee are allowed.

Source: ITAT, Delhi in Ecorys Nederlands B. V. vs. ADIT
ITA No. 6494 of 2016, dated Nov 11, 2020

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FTS taxability to arise only when 'Make Available Clause' is satisfied

Facts

The assessee is a non-resident under the provision of Income Tax Act, 1961 and is a tax resident of Sweden in terms of Article-4 of India Sweden Tax Treaty. It is engaged in the business of manufacturing of train control and signaling systems for mass transit system. It was observed by the Assessing Officer that the assessee had rendered intermediary services like marketing, sales, business development, project management, customer services etc. and had received fees for intermediary services. The assessee was asked to explain why these revenues may not be taxed in India as Fee for Technical Services like in the immediately preceding year. It was the assessee's submission before the Assessing Officer that the assessee was the HUB entity for the Rail Control Solutions businesses of Bombardier group and it housed functional heads for various functional areas like administration, procurement, engineering, quality, control program management and marketing, each catering to worldwide Rail Control Solutions business. It was also submitted, while referring to the agreement with BTIN, that there was no markup by the assessee in respect of the services rendered to BTIN. The assessee also claimed benefit of provision of Article 12 of India- Sweden Doubt Taxation Avoidance Agreement and submitted that in the instant case, rendering of intermediary services by the assessee does not 'make available' any technical knowledge, skill etc. to BTIN and, therefore, FTS was not taxable in India. However, the Assessing Officer did not accept the contention of the assessee and proceeded to make addition of Rs.1,44,09,831/- to the returned of income of the assessee on account of FTS.

Ruling

The Tribunal held that here was no dispute that during the year under consideration, the appellant has rendered services like marketing, sales, design development, project management customer services etc. and has received fees amounting to Rs. 1.16 crores which have not been offered for tax in the return of income. It is equally true that the appellant is HUB entity for RCS business of Bombardier group and accordingly, the appellant rendered intermediary services to BTIN.

Since the appellant is a tax resident of Sweden, it is entitled to benefits of Indo Sweden DTAA and protocols thereof, and Protocol 7 of the Treaty provides scope of taxability of FTS which is restricted on account of agreement between India and a third state. We find that under the India Portuguese Treaty, scope of FTS is restricted on

account of requirement of 'Make Available' clause. On this basis, the CIT(A) in A.Y 2010-11, has categorically observed that the said intermediary services rendered by the appellant to BTIN does not satisfy the 'Make Available' clause and does not amount to FTS. In opinion of the Tribunal, the technical or consultancy services rendered should be aimed at and result in transmitting technical knowledge, etc., so that the payer of the service could derive an enduring benefit and utilize the knowledge or know-how on his own in future without the aid of the service provider. The technical knowledge or skills of the provider should be imparted to and absorbed by the receiver so that the receiver can deploy similar technology or techniques in the future without depending upon the provider. Technology will be considered 'made available' when the person acquiring the service is enabled to apply the technology.

The fact that the provision of the service that may require technical knowledge, skills, etc., does not mean that technology is made available to the person purchasing the service. Payment of consideration would be regarded as 'fee for technical/included services' only if the twin test of rendering services and making technical knowledge available at the same time is satisfied. For this, the tribunal derived support from the decision of the Hon'ble Karnataka High Court in the case of De Beers India Minerals Private Limited 346 ITR 467. In consideration of totality of facts, the Tribunal opined that intermediary services rendered by the appellant do not make available any technical knowledge, skill etc. to BTIN and BTIN is not equipped to apply technology contained in services rendered by the appellant. Therefore, the intermediary services provided by the appellant to BTIN do not tantamount to FTS and accordingly, shall not be taxable in India.

Source: ITAT, Delhi in DCIT vs. Bombardier Transportation Sweden Ab; ITA No. 4185 of 2018, dated Nov 27, 2020

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