TAX HIGHLIGHTS

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Table of contents

1	Permanent establishment	7	Disallowance under Section 14A
2	Royalty and fees for technical services	8	Minimum Alternate Tax
3	AAR application	9	Other direct tax developments
4	Applicability of Section 206AA	10	Transfer pricing
5	MFN clause	11	Individual taxation
6	Non-discrimination	12	Indirect taxes

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Permanent Establishment

Income attributable to the taxpayer's foreign branches having a PE outside India is not taxable in India

The taxpayer had sought relief in respect of the profit earned by the foreign branches on the basis of respective tax treaties. The Assessing Officer (AO) granted a benefit in respect of the branches at Singapore and Japan but denied the benefit to the taxpayer in respect of the other branches. The Commissioner of Income-tax (Appeals) [CIT(A)] allowed the taxpayer's claim. The Tribunal held that in the case of all the foreign countries, the operations were carried out through its branches which is a Permanent Establishment (PE) situated outside India. Therefore, the income attributable to these branches cannot be taxed in India. The Tribunal followed its earlier ruling where on perusal of Articles 23, 24 and 25 of the relevant tax treaties, it was held that the laws in force in either of the contracting states would govern the taxation of income in the respective contracting states i.e. credit of tax paid in one state would be given in the other state.

The Bombay High Court held that income attributable to the taxpayer's foreign branches having a PE outside India is not taxable in India. If the taxpayer has a PE abroad, then, the taxpayer would be required to produce evidence regarding payment of taxes pertaining to the income of these establishments abroad. On production of such evidence, the taxpayer would be entitled to the tax treaty benefit.

CIT v. Bank of India [2016] 64 taxmann.com 215 (Bom)

For further details, please refer to our Flash News dated 5 January 2016 available at this link

Project office for installation of petroleum platforms and submarine pipelines does not constitute a PE in India

The taxpayer is a company incorporated in the UAE, engaged in fabrication of petroleum platforms, pipelines and other equipment. The taxpayer entered into contracts with ONGC for installation of petroleum platforms and submarine pipelines. Whilst the activities relating to survey, installation and commissioning were done entirely in India, the platforms were designed, engineered and fabricated overseas. The AO held that the taxpayer had a fixed place PE as well as installation/construction PE in India. It was held that Arcadia Shipping Ltd. (ASL), a consultant, constituted a Dependent Agent Permanent Establishment (DAPE) of the taxpayer in India. Accordingly, the AO held that the entire contractual receipts including the activities performed outside India were taxable in India.

High Court's ruling

Interplay of Article 5(1), 5(2) and 5(3) of the tax treaty

Article 5(1) and 5(2) of the tax treaty complement each other. Thus, all classes of PEs as specified in Article 5(2) of the tax treaty would be construed as a PE subject to the essential conditions of paragraph 1 of Article 5 being met. Paragraph 3 of Article 5 of the tax treaty is an exclusionary clause and is intended to exclude certain places of business from the scope of the expression PE. Paragraph 3 begins with a non obstante clause. Thus, the exclusions provided under paragraph 3 would override the provisions of paragraph 1 and 2 of Article 5 of the tax treaty. Thus, even though the taxpayer's PO established in India falls within the definition of PE in terms of paragraph 1 and 2 of Article 5 of the tax treaty, it would still have to be seen whether it stands excluded under paragraph 3 of Article 5 of the tax treaty. In the context of Article 5(3)(e) of the tax treaty, the expression would necessarily mean carrying on activities, other than the main business functions, that aid and support the tax treaty. Where the main business is fabrication and installation of platforms, acting as a communication channel would clearly qualify as an activity of auxiliary character. Therefore, the activity of the taxpayer's PO in India would clearly fall within the exclusionary clause of Article 5(3)(e) of the tax treaty, and it cannot be construed as a PE in India.

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Installation PE

An activity which may be related or incidental to the project but which is not carried out at the site in the source country would clearly not be construed as a PE as it would not comply with the essential conditions as stated in Article 5(1) of the tax treaty. The site or the attendant office in respect of the site/project itself would constitute a fixed place of business once the taxpayer commences work at a site. Thus, in order to apply Article 5(2)(h) of the tax treaty, it is essential that the work at a site or the project commences. It is not relevant whether the work relates to planning or actual execution of construction works or assembly activities.

Where the taxpayer did not have access to the site during a relevant period, the same cannot be construed as its PE under Article 5(2)(h) of the tax treaty. In the present case, the installation activities were less than the minimum period of nine months. Even if the time spent by ASL in conducting the pre-engineering and pre-design survey is included, the duration of the project activities in India would not exceed nine months. Therefore, if the duration of the project activities in India was less than nine months, it cannot be held that the taxpayer had a PE in India under Article 5(2)(h) of the tax treaty.

DAPE

On perusal of the director's report and the final accounts of ASL, it indicates that the activity of providing offshore marketing/technical consultancy and offshore fabrication and installation work were amongst the regular activities carried out by ASL. ASL had agreed to act as a 'sole and exclusive' consultant for the taxpayer in India and had further agreed not to represent any competitor of the taxpayer or act in a manner detrimental to the taxpayer's interest. The taxpayer had also duly disclosed ASL to be its agent involved in the contract as well as the remuneration payable to ASL. The representatives of ASL were present at the pre-bid meeting held with ONGC as well as at the kick-off meeting. The presence of ASL at such a meeting was clearly in pursuance of the services agreed to be rendered by them. However, this by itself cannot lead to an inference that ASL constituted a DAPE of the taxpayer in India.

On a perusal of Article 5(5) of the tax treaty, it indicates that ASL has acted on behalf of the taxpayer in its normal course of business. Although the correspondence between the taxpayer and ASL indicated that ASL was involved in the project since the pre-bid meeting and had also acted on behalf of the taxpayer, it cannot be concluded that ASL was habitually authorised to conclude contracts on behalf of the taxpayer. Accordingly, ASL would not constitute a DAPE of the taxpayer in India.

National Petroleum Construction Company v. DIT [2016] 383 ITR 648 (Del)

For further details, please refer to our Flash News dated 2 February 2016 available at this link

A foreign company engaged in outsourcing services constitutes a business connection under the Income-tax Act but does not have a PE in India under the India-UK tax treaty

The taxpayer, a UK based company, is engaged in outsourcing services for its clients in finance, utility and the public sector. The main services provided by the taxpayer are customer management outsourcing business, service outsourcing and transfer of technology. Vertex Customer Service India Pvt. Ltd (Vertex India) is an Indian entity in the group, which also carries out outsourced work from the taxpayer. This outsource work is in relation to contracts of the taxpayer with PowerGen Retial Ltd. and Last Minute Networks Ltd. The taxpayer allowed Vertex India, the right to use certain equipment located outside India and claimed reimbursement of expenses incurred on behalf of Vertex India. The taxpayer offered the payment received from Vertex India for the right to use equipment outside India as royalty under Article 13(3)(b) of the tax treaty. Regarding the reimbursement, it was claimed that the same was not taxable as it was on a cost to cost basis.

The AO held that the taxpayer has a PE in India under the India-U.K. tax treaty as well as a business connection under the Income-tax Act, 1961 (the Act) and hence computed the profit

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attributable to such a PE. Regarding reimbursement as it has the effect of reducing the service fee payable to the Indian company was also considered as business profits of the PE in India. Further, royalty was also taxed as a business profit of the PE in India.

The Delhi Tribunal held that the taxpayer has a business connection in India under Section 9(1)(i) of the Act. With regard to PE, it was observed as follows:

Fixed place PE

In the present case, it was not established that the premises were made available to a foreign enterprise. The space provided was not at the disposal of the enterprise since it had no right to occupy the premises. Merely an access was given for the purpose of work, does not satisfy the disposal test. Accordingly, it was held that taxpayer does not have a fixed place PE in India.

Dependent agent PE

In view of the business model of the taxpayer and in the absence of material to suggest that the conditions mentioned in Article 5(4) of the tax treaty are satisfied, it was held that Vertex India does not constitute a dependent agent PE in India.

It was also held that the taxpayer has no Service PE in India.

The Tribunal held that since there is no PE of the taxpayer in India, the business income is not chargeable to tax in India. Even if it is assumed that there is a PE of the taxpayer in India, no profit can be attributed since the PE was compensated at an ALP in accordance with Functions, Assets and Risk (FAR) analysis.

DCIT v. Vertex Customer Management Ltd. [2016] 158 ITD 365 (Del)

For further details, please refer to our Flash News dated 18 March 2016 available at this link

Indian subsidiary of a US company does not constitute PE in India as it does not satisfy any of the test of PE Article of the India-USA tax treaty

The taxpayer is a US company providing software solutions for network publishing and has a wholly owned subsidiary in India. Adobe India provides software related Research and Development (R&D) services to the taxpayer. The taxpayer paid for R&D services on cost plus basis and claimed that the agreement was on principal to principal basis. However, based on the services rendered, the AO held that Adobe India ought to be considered as PE of the taxpayer. Accordingly, the AO issued notices under Section 148 on 30 March 2011 contending that taxpayer's income attributable to its India PE had escaped assessment in respect of Assessment Years (AYs) 2004-05, 2005-06 and 2006-07.

High Court's ruling

Subsidiary PE

- In the present case, Adobe India is a separate taxpayer and is liable to pay tax on its income. The fact that a holding company in another contracting state exercises certain control and management over a subsidiary would not render the subsidiary as a PE of the holding company. This is expressly spelt out in Article 5(6) of the tax treaty.
- However, the fact that a subsidiary company is a separate tax entity does not mean that it could never constitute a PE of its holding company. In certain circumstances, where the specified parameters defining PE are met, a subsidiary would constitute a PE of its holding company. However, in determining whether the requisite parameters are met, it is necessary to bear in mind that a subsidiary is a separate legal entity and its activities, the income from which are assessed in its hands at arm's length pricing, cannot be the sole basis for the purposes of imputing the subsidiary to be a PE of its holding company.
- It has been observed that a subsidiary is liable to pay tax on its income and a foreign holding company is liable to pay tax on its income. The same set of activities cannot be construed as that of a holding company through its PE and that of the subsidiary as its own activity resulting in

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income from the same activities being taxed twice over; once in the hands of the subsidiary and again in the hands of the holding company.

Fixed place PE

- The fixed place must be at the disposal of an enterprise through which it carries on its business wholly or partly. Although, the word 'through' has been interpreted liberally but the very least, it indicates that the particular location should be at the disposal of the taxpayer for it to carry on its business through it. These attributes of a PE under Article 5(1) of the tax treaty were elucidated by the Supreme Court in Morgan Stanley[1].
- Thus, the right to use test or the disposal test was not satisfied for concluding that the taxpayer had a PE in India in terms of Article 5(1) of the tax treaty.

Service PE

- The stipulation as to provide specification and further assistance is only for the purpose of ensuring that the taxpayer procures the service that it has contracted for from Adobe India. Such clauses in the agreement cannot lead to the inference that the taxpayer has a PE in India for rendering services as per the provisions of Article 5(2)(l) of the tax treaty

Agency PE

- One of the necessary conditions for holding that an agent constitutes a PE of an enterprise is that the agent must have an authority to conclude contracts or should have been found to be habitually entering into or concluding contracts on behalf of the enterprise. In the present case, there is no allegation that Adobe India was authorised to conclude contracts on behalf of the taxpayer or has been habitually doing so. There was neither any agreement which states so nor any material which indicated that Adobe India acts as such.
- It is not disputed that Adobe India was assessed on its income determined at Arm's Length Price (ALP) and therefore, there was no occasion to assume that Adobe India constituted the taxpayer's PE under Article 5(5) of the tax treaty.

Adobe Systems Incorporated v. ADIT [2016] 24 Taxman 353 (Del)

For further details, please refer to our Flash News dated 7 June 2016 available at this link

35 per cent of net global profits are attributed to Indian PE of a Chinese company in respect of both hardware and software supplied to Indian customers

The taxpayer is a Chinese company engaged in the business of providing telecom equipment. The taxpayer was engaged in supply of telecom equipment to Indian telecom operators. The taxpayer was also engaged in supply of mobile handsets to various customers in India. During the year under consideration, the taxpayer did not file its return of income in India on the ground that it did not have PE in India under the India-China tax treaty.

The AO held that the taxpayer had a business connection in India and its business had been carried through its PE in India. The AO held that the taxpayer had fixed a place PE, an installation PE and dependent agent PE in India and therefore, the revenues from the supply of telecom equipment and mobile handsets were to be taxed in India as business profits. He held that the profits of the PE in India have to be computed separately in respect of hardware and software components of the telecom equipment and the mobile handsets. The payments for the supply of software embedded in the telecom equipment should be treated as royalty under Section 9(1)(vi) of the Act and also under Article 12(3) of the tax treaty. As regards the attribution of profits to the PE in India in respect of hardware component, the AO invoked Rule 10 of the Rules and determined the income of the taxpayer's PE at 20 per cent of the net global profits from AYs 2004-05 to 2008-09. However, for AY 2009-10, the AO has attributed 45 per cent of the operating profit

The CIT(A) held that the taxpayer had a fixed place PE and dependent agent PE in India. However,

[1] DIT v. Morgan Stanley & Company Inc. [2007] 292 ITR 416 (SC)

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he did not accept the AO's plea of having installation PE in India. The CIT(A) held that software embedded in the telecom equipment was taxable as business profits, and not royalty. As regards the computation of profits attributable to the PE, 2.5 per cent of total sales made by foreign company in India were held to be attributed as business profits of the PE (including the value of software).

The Tribunal observed that the taxpayer agreed for attribution of profits to PE without prejudice to its claim that there was no PE in India. The fundamental principle governing the attribution of profits is that once the domestic law has determined that business income has a source in the country, the mechanics of law then apply to calculate the amount of taxable profit. The Tribunal held that almost entire sales functions, including marketing, banking and after sales, were carried out by taxpayers' PE in India and, therefore, 35 per cent of net global profits as per published accounts are attributed to the PE in India in respect of hardware and software supplied to Indian customers. The Tribunal observed that for the purpose of attribution of profits to the PE, the most important aspect to be kept in mind is the level of PE's participation in the economic life of source country. It is primarily nexus between source country and the PE's activities which produce the taxable income to the taxpayer. In the present case, since the taxpayer has not maintained books of accounts relating to PE in India, indirect method prescribed in Rule 10 of the Income-tax Rules, 1962 (the Rules) for attribution of profits was resorted. The Tribunal observed that the issue of attribution of profits depends on the facts of the case and is fully dependent on the level of operations of the activities carried out in India.

ZTE Corporation v. ADIT [2016] 159 ITD 696 (Del)

For further details, please refer to our Flash News dated 10 June 2016 available at this link

Royalty and Fees for Technical Services

Fees for supply management services are neither taxable as royalty nor as fees for technical services under the India-UK tax treaty

The applicant is a company incorporated in the U.K. Cummins Technologies India Limited (CTIL) is an Indian company engaged in the business of manufacture and sale of turbochargers. CTIL purchases turbocharger components directly from a third party in the U.K. and the U.S. and in relation to such purchases, the applicant, provides supply management services. In terms of the agreement, CTIL pays supply management service fees calculated at 5 per cent of the base price of the suppliers. The applicant does not have a PE in India in respect of the supply management services as per the provisions of the tax treaty.

AAR ruling

Taxability of FTS

On perusal of the agreement, it indicates that the CTIL is working with the applicant only to ensure market competitive pricing from the suppliers. The applicant maintains contract supply agreements with the suppliers after identifying the products availability, capacity to produce and competitive pricing. The applicant is not imparting its technical knowledge and expertise to the Indian company. Therefore, the 'make available' clause under the India-UK tax treaty is not satisfied. The services rendered in the present case are managerial in nature and were taken out of the ambit of Fees for Technical Services (FTS) of the India-UK tax treaty with effect from 11 February 1994 and a clause relating to 'make available' was inserted. It indicates that the intention was to introduce such a clause and exclude managerial services. Therefore, the supply management services were not taxable as FTS in India.

Applicability of the anti-avoidance provisions

There is no mandate for CTIL to source the components from the approved suppliers only and if CTIL finds a better pricing from an alternate supplier, it shall be free to source the component from them. It is incorrect to say that such an arrangement has been done with the main purpose to avoid

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tax.

Taxability of royalty

The nature of services related to identification of products and competitive pricing cannot qualify as royalties under Article 13 of the tax treaty because it is not related to the use of, or the right to use any copyright, patent, trademark, design or modal, plan, secret formula or process, etc. Accordingly, it has been held that the supply management services fees received by the applicant are not in the nature of FTS or royalties under the India-UK tax treaty.

Cummins Limited [2016] 381 ITR 44 (AAR)

For further details, please refer to our Flash News dated 29 January 2016 available at this link

Payment for data transmission service through a transponder is not royalty under the India-Thailand and India-Netherlands tax treaties

The taxpayer is a company incorporated in Thailand, engaged in the business of providing digital broadcasting services as well as consultancy services to its customers who consist of both Indian residents and non-residents. The taxpayer provides these services through its satellite whose footprint covers a large geographical area, including India. Another taxpayer is a company incorporated in Netherlands, engaged in providing digital broadcasting services. Both the taxpayers in the present case derive income from the 'lease of transponders' of their respective satellites. The taxpayers had filed nil returns for the relevant assessment years. The AO held that the income was taxable under Section 9(1)(vi) of the Act as well as under Article 12 of the India-Thailand/India-Netherlands tax treaties. The issue before the Delhi High Court was whether the income derived by the taxpayers through data transmission services was taxable as royalty under Section 9(1)(vi) of the Act as well as Article 12 of the tax treaty. Whether the amended definition of royalty under the Act can be used to interpret the definition of royalty in the tax treaties.

High Court's ruling

Taxability under the Act

- Explanations 4 to 6 are designed as clarificatory amendments. Unarguably they have all the apparent characteristics of one. The words 'for the removal of doubts, it is hereby clarified…includes and has always included' qualify the interpretation in Explanation 5. In Explanation 6, the same words have been modified and they state 'includes and has always deemed to have always included'. This is the standard language used to communicate an intended retrospective effect.
- The circumstances in this case could very well go to show that the amendment was no more than an exercise in undoing an interpretation of the court which held income from data transmission services as non-taxable under Section 9(1)(vi) of the Act.
- The issue of taxability of the income of the taxpayer in this case may be resolved without redressal of the above question purely because the taxpayer has not pressed this line of arguments before the court and instead stated that even if it were to be assumed that the contention of the tax department is correct, the ultimate taxability of this income shall rest on the interpretation of the terms of the tax treaties.
- The High court therefore proceeds with the assumption that the amendment is retrospective and the income is taxable under the Act.

Taxability under the tax treaty

- No amendment to the Act, whether retrospective or prospective can be read in a manner so as to extend its operation to the terms of an international treaty.
- Clarificatory or declaratory amendment, which may seek to overcome an unwelcome judicial interpretation of law, cannot be allowed to have the same retroactive effect on an international instrument effected between two sovereign states prior to such amendment.

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- The Parliament is simply not equipped with the power to, through domestic law, change the terms of a treaty. A treaty is not drafted by the Parliament; it is an act of the executive.
- Mere amendment to Section 9(1)(vi) of the Act cannot result in a change. It is imperative that such amendment is brought about in the tax treaty as well.
- Since the Finance Act, 2012 will not affect Article 12 of the tax treaties, it would follow that the first determinative interpretation given to the word 'royalty' in Asia Satellite, when the definitions were in fact *pari materia* (in the absence of any contouring explanations), will continue to hold the field for the purpose of assessment years preceding the Finance Act, 2012 and in all cases which involve a tax treaty, unless the said tax treaties are amended jointly by both parties to incorporate income from data transmission services as partaking of the nature of royalty, or amend the definition in a manner so that such income automatically becomes royalty.

DIT v. Shin Satellite Public Co Ltd [ITA 500/2012], DIT v. New Skies Satellite BV [ITA 473/2012] (Del) – Taxsutra.com

For further details, please refer to our Flash News dated 17 February 2016 available at this link

Taxpayer is a beneficial owner of royalty and therefore eligible for beneficial tax rate under the India-Singapore tax treaty

The taxpayer, a company, incorporated in Singapore, was a 100 per cent subsidiary of a French company. The principal activities of the taxpayer were to act as a headquarters for the Asia-Pacific region, rendering administrative, marketing and sales services to the group and affiliated companies, trading in paper and performance minerals and other related business activities including project work. A UK based company (a group company of the taxpayer) developed know-how for manufacture of products. The UK company wants to develop the sub-licensing market in the Asia Pacific region for its knowhow and wished the taxpayer to act as sub-licensor in order to develop its market. Therefore, the UK company entered into a know-how agreement with the taxpayer.

The taxpayer in lieu of this license granted, entered into a technology agreement with an Indian company. Under the technology agreement, the taxpayer undertook to provide a non-exclusive, non-transferable, non-assignable and revocable license to an Indian company. Such license was provided to use the technology and know-how in connection with the development, manufacture, use and sale of calcium carbonate and calcium carbonate products in the geographical territory of India.

During the year under consideration, the taxpayer had received payment on account of royalty. The receipt was offered to tax at the beneficial rate prescribed under the tax treaty. The AO held that the taxpayer was not the beneficial owner of the royalty, and therefore, it was not eligible to claim the lower rate of tax for royalty under the tax treaty. The AO held that beneficial owner of royalty was the UK company. The know-how was actually transferred to the Indian entity by the UK company, and the taxpayer was only acting as an agent for taking the benefit of the lower rate as per the tax treaty.

Based on facts of the case, the Tribunal held that the taxpayer was the beneficial owner of royalty in line with the provisions of Article 12 of the tax treaty and the same was to be taxed at 10 per cent. The Tribunal observed that the taxpayer had entered into the know-how agreement with the UK based company which in turn was sub-licensed by the taxpayer to an Indian company and received royalty income on the same. The royalty income has been received in its own right as the beneficial owner.

Imerys Asia Pacific Pvt. Ltd., v. DDIT [2016] 180 TTJ 544 (Pune)

For further details, please refer to our Flash News dated 3 May 2016 available at this link

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Marketing services for expansion of business overseas are not in the nature of FTS

The taxpayer is a stock broker company in India and carries on the business of brokerage on behalf of its institutional clients. During the year under consideration, the taxpayer company made payments to its subsidiaries in the U.K. and Singapore for providing marketing support services and towards the expansion of its business in the U.K. and Singapore along with the European region and the South East Asian countries respectively.

As consideration for their services, the taxpayer company remunerated the subsidiaries by reimbursing their costs along with a service fee of 29 per cent on the costs. No tax was deducted at source on such reimbursement of costs made to the subsidiaries. The AO considered that the taxpayer company was bound to deduct tax at source on the entire remittance (including reimbursement) since the entire payment made to the non-resident subsidiaries constituted FTS and were taxable in their hands. Pursuantly, the AO disallowed the payment made as reimbursement to the subsidiary for non-deduction of tax at source. The CIT(A) upheld the disallowance by observing that tax was required to be deducted on gross payments by the taxpayer.

The Kolkata Tribunal held that the services provided by the subsidiaries were in the nature of marketing services of introducing foreign institutional investors to invest in the capital markets in India. Article 12(4) of the India-Singapore tax treaty and Article 13(4) of the India-U.K. tax treaty is the same as Article 12(4)(b) of the India-U.S. tax treaty and thus the Memorandum of Understanding to the India-U.S. treaty could be used as aid to understand if services constituted as FTS. Given the language used in the tax treaties, unless services also make available technical knowledge, skill, experiences, etc. to the recipient of the services, the same do not qualify as FTS under the tax treaties. Since no technical service was being made available to the taxpayer by its subsidiaries, payments did not fall within the definition of FTS as per the provisions of the tax treaties. Accordingly, the Tribunal directed the AO to delete the disallowance.

Batlivala & Karani Securities (India) (P.) Ltd [2016] 71 taxmann.com 142 (Kol)

For further details, please refer to our Flash News dated 18 July 2016 available at this link

AAR application

The Delhi High Court holds on acceptability of AAR application in different situations

The taxpayer is incorporated in South Korea. It is a comprehensive energy solution provider and manufactures transformers, switchgears, motors, decelerators and industrial pumps and is also engaged in the wind energy business. It supplies transformers to customers all over the world including India. The taxpayer, being a successful bidder, supplied equipments to Power Grid Corporation of India Ltd. (PGCIL). The taxpayer claimed that revenue from offshore supplies was not liable to be taxed in India. Therefore, the taxpayer claimed refund of tax deducted by PGCIL. In reference to each of the returns filed by the taxpayer, notices were issued both under Section 143(2) of the Act as well as 142(1) of the Act by the AO. The taxpayer filed applications before the Authority for Advance Rulings (AAR) seeking a ruling on the issue of taxability of the profits from offshore supplies made during the aforementioned AYs to PGCIL. The AAR while rejecting the taxpayer's applications, held that the notices under Section 143(2) were already issued prior to the filing of the application before the AAR and therefore, the question raised in the application for advance ruling was pending for adjudication before the assessing authority and the bar created under clause (i) of the proviso to Section 245(2) of the Act operates.

High Court ruling

Whether question was pending before the tax authority

- Mere filing of a return by the taxpayer claiming the refund in respect of the tax deduction by PGCIL will not tantamount to the question raised in the applications before the AAR being

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pending before the income tax authorities.

- As far as the notice under Section 143(2) of the Act is concerned, that provision itself stipulates that such notice will be issued by the AO where he has reason to believe that any claim of such exemption, deduction, allowance or relief made in return is inadmissible. It mandates that the notice should specify the particulars of such claim, loss, exemption, deduction or relief.
- The notice issued in the present case to the taxpayer under Section 143(2) of the Act is in a standard pre-printed format which merely states that 'there are certain points in connection with the return of income on which the AO would like some further information'. The said notice fails to satisfy the particulars of claim of loss, exemption, deduction, allowance or relief as mandated by Section 143(2)(i) of the Act.
- In any event the question raised in the applications made by the taxpayer before the AAR do not appear to be forming the subject matter of the notices under Section 143(2) of the Act. Consequently, the mere fact that such a notice was issued prior to the filing of the application by the taxpayer before the AAR will not constitute a bar, in terms of clause (i) to proviso to Section 245R(2) of the Act. However that cannot be said of the notices under Section 142(1) of the Act issued to the taxpayer by the AOs for AYs 2008-09 and 2009-10 which were prior to the filing of the applications before the AAR.
- It is not in dispute that the notices under Section 142(1) of the Act were accompanied by a questionnaire which raised the question of supply contracts which according to the taxpayer were executed overseas. Therefore, where the notices under Section 142(1) of the Act raising the very questions that form subject matter of the applications by the taxpayer before the AAR for AYs 2008-09 and 2009-10 were issued prior to the filing of the applications, clause (i) of the proviso to Section 245R(2) of the Act gets attracted.
- Accordingly, the applications filed by the taxpayer in respect of the transaction of supply of equipment for AY 2008-09 and 2009-10 were rightly rejected by the AAR since on the date of filing of such applications before the AAR, the question raised therein was already pending before the income tax authorities by virtue of the notices under Section 142(1) of the Act having already been issued to the taxpayer.
- However as regards the applications concerning the supply contracts executed during AY 2010-11, the AAR erred in rejecting them by applying clause (i) to proviso to Section 245R(2) of the Act. Notices under Section 142(1) of the Act in respect of those transactions pertaining to AY 2010-11 were issued only after the filing of the application before the AAR. The High Court restored the said applications to the file of the AAR for a decision afresh in accordance with law.

Hyosung Corporation v. AAR [2016] 382 ITR 371 (Del)

For further details, please refer to our Flash News dated 22 February 2016 available at this link

Applicability of Section 206AA

When the foreign recipient is eligible for the benefit of the tax treaty, there is no scope for deduction of tax at source at the rate of 20 per cent under Section 206AA of the Act

The taxpayer filed its quarterly electronic tax deduction at source returns in Form No.27Q in respect of the payment made to non-residents. The AO issued an intimation providing a summary of the short deduction and interest payable for delayed deposit of tax. The AO along with an intimation under Section 200A the Act also issued a demand notice under Section 156 of the Act. The taxpayer contended before the CIT(A) that the AO issued the demand without giving effect to the provisions of the tax treaty. The taxpayer had deducted tax in accordance with the provisions of the respective tax treaty and therefore, there was no shortfall in the deduction of tax at source in respect of the payments made to nonresidents. The CIT(A) confirmed the action of the AO.

The Bangalore Tribunal observed that an identical issue was considered and decided by the Pune

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Tribunal in the case of Serum Institute of India Ltd. [2015] 56 taxmann.com 1 (Pune). Reliance was also placed on the decision of the Karnataka High Court in the case of Bharti Airtel Ltd. [2014] 52 taxmann.com 31 (Kar). The Bangalore Tribunal held that the provisions of Tax Deducted at Source (TDS) had to be read along with the tax treaty for computing the tax liability on the sum in question. Therefore, when the recipient is eligible for the benefit of a tax treaty, then there is no scope for deduction of tax at source at the rate of 20 per cent as provided under the provisions of Section 206AA of the Act. Similarly, on the issue of jurisdiction, it was held that the question of computing the rate of 20 per cent under Section 206AA of the Act is a debatable issue when the recipient is eligible for the benefit of provisions of the tax treaty, and therefore, the AO cannot proceed to make the adjustment while issuing an intimation under Section 200A of the Act.

Wipro Ltd. vs ITO [IT(IT) A. Nos.1544 to 1547/Bang/2013, (AY 2011-12)]

For further details, please refer to our Flash News dated 2 March 2015 available at this link

Section 206AA of the Act does not override the beneficial provisions of the tax treaty

The taxpayer filed statements of deduction of tax at source in the Form 27Q for 2nd and 3rd quarters of the AY 2011-12 in respect of payments made to non-resident during the relevant period. The AO on examination of Form 27Q issued intimation under Section 200A of the Act and held that there was a short deduction of tax at source. Accordingly, the AO raised a demand with interest chargeable on such short deduction of tax. The CIT(A) observed that the provisions of Section 90(2) of the Act will override all other provisions of the Act since that section aims to give effect to tax treaty entered between India and other foreign governments. Thereafter, the CIT(A) directed the AO to deduct tax at source at 10 per cent as against 20 per cent demanded by the AO.

The Tribunal in the present case has referred the decision of the Pune Tribunal in the case of DCIT v. Serum Institute of India Ltd. [2015] 56 taxmann.com 1 (Pune) wherein the Pune Tribunal has categorically held that Section 206AA of the Act does not override the provisions of Section 90(2) of the Act and accordingly the rate of tax deducted at source prescribed in the tax treaty shall prevail. Following the said decision, the order of the CIT(A), who has only directed the AO to compute tax at 10 per cent as prescribed in the tax treaty has been upheld. Consequently, Section 200A of the Act cannot be invoked in the case of the taxpayer.

DCIT v. Pricol Ltd (ITA No. 56 & 57/Mads/2014) – Taxsutra.com

For further details, please refer to our Flash News dated 27 June 2016 available at this link

MFN clause

Payment for managerial services cannot be taxed as FTS on application of MFN clause under the India-France tax treaty

The taxpayer is a public limited company registered in India providing IT driven services for its clients' core businesses. The taxpayer is assessed to tax as a resident in India. Steria France is a non-resident company incorporated in France as a limited liability partnership. Steria France centralizes technical skills for carrying on management functions such as legal finance, human resources, communication risk control, information systems, controlling and consolidation, delivery and industrialisation, technology and management information services. Steria France does not have any office presence or personnel in India and a PE in India.

The taxpayer entered into a management service agreement with Steria France. Under the said agreement, Steria France was to provide various management services to the taxpayer with a view to rationalise and standardise the business conducted by the taxpayer in India. These services are provided by Steria France through telephone, fax, e-mail, etc. and no personnel of Steria France visited India for providing such services.

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The taxpayer filed an application before the AAR seeking a ruling on whether the payment made for the management services provided by Steria France is taxable in India in the hands of Steria France under the tax treaty. The AAR ruled that the protocol to the India-France tax treaty could not be treated as a part of the tax treaty itself. The restrictions imposed by the protocol to the India-France tax treaty using Most Favoured Nation (MFN) clause were only to limit the taxation at source for the specific items mentioned therein. The restriction was only on the rates. Further, the 'make available' clause provided in the India-UK tax treaty could not be read into the expression

The High Court held that on perusal of the MFN clause under the protocol of the tax treaty, the High Court finds no warrant for the restrictive interpretation of the protocol. The words 'a rate lower or a scope more restricted' occurring in the protocol envisages that there could be a benefit on either score i.e. a lower rate or more restricted scope. One does not exclude the other. The benefit of protocol could accrue in terms of lower rate or a more restrictive scope under more than one tax treaty which may be signed after 1 September 1989 between India and a third state which is an OECD member.

The purpose of the protocol is to afford a party to the tax treaty the most beneficial provisions that may be available in another tax treaty between India and another OECD country. The AAR has failed to notice the wording of the protocol which makes it self-operational. Once the tax treaty has itself been notified, and contains the protocol, there was no need for the protocol itself to be separately notified or for the beneficial provisions in some other tax treaty between India and another OECD country to be separately notified to form part of the tax treaty.

The definition of FTS occurring in Article 13(4) of the India-UK tax treaty excludes managerial services. By virtue of MFN clause the same benefit is available under India-France tax treaty. In the present case, Steria France has provided managerial services to the taxpayer in terms of the management services agreement. Once the expression 'managerial services' is outside the ambit of FTS, then the question of withholding of tax on payment for the managerial services, would not arise.

Steria (India) Ltd vs. CIT [2016] 386 ITR 390 (Del)

For further details, please refer to our Flash News dated 3 August 2016 available at this link

Non-discrimination

No disallowance under Section 40(a)(i) of the Act for non-deduction of tax at source in view of non-discrimination clause under the India-USA tax treaty

The taxpayer is an Indian subsidiary of Herbalife of International America Inc. (US Company) and carries on business of trading and marketing of herbal products. The taxpayer entered into an Administrative Services Agreement (ASA) with US Company for the provision of certain administrative services. During the AY 2001-02 the taxpayer paid administrative fee to US Company without withholding tax at source. The AO disallowed the administrative fee under Section 40(a)(i) of the Act on the ground that the same were in the nature of FTS under the Act as well as the India-USA tax treaty (tax treaty). The CIT(A) upheld the order of the AO. Before the Tribunal an additional ground was raised invoking Article 26(3) of the tax treaty dealing with 'Non Discrimination'. The taxpayer contended that the provisions of Section 40(a)(i) of the Act, prior to insertion of sub-clause (ia) in Section 40(a) of the Act by the Finance (No.2) Act, 2004, were discriminatory in nature, entailing disallowance for payments made to non-residents alone. The Tribunal allowed the ground and gave relief to the taxpayer.

High Court's ruling

- Expenditure otherwise deductible under Section 37 was to be disallowed under Section 40(a)(i) of the Act, for the year under consideration, if payment was made to a non-resident. The disallowance of expenses for non-deduction of tax on payments made to a resident was inserted

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by way of Section 40(a)(ia), only with effect from 1 April 2005. Before such insertion, the condition under which expenses were deductible i.e. whether tax was deducted or not was not the same in respect of payments to residents and non-residents. While tax deduction from payments to non-residents may be justified, that does not meet the test of Article 26(3) as regards condition for deductibility of the payment itself. The conditions for deductibility were plainly different in respect of payments made to residents and non-residents. Therefore, non-discrimination rule under Article 26(3) of the tax treaty was attracted.

- The term 'other disbursements' in Article 26(3) of the tax treaty could not be construed applying the doctrine of *ejusdem generis* and thus the payment of FTS was covered in the scope of the term.
- While interpreting the tax treaty provisions, the line of argument cannot be similar to one employed while arguing the justification of a classification with reference to nexus of the objective of a statute to determine its vires under the Constitution.
- The plea of the tax department that unless there are provisions similar to Section 40(a)(i) of the Act in the tax treaty, a comparison cannot be made to determine which is a more beneficial provision is erroneous. The provisions of the tax treaty will prevail unless any specific provision in the Act is more beneficial to the taxpayer.
- Reliance by the tax department on the decision of the Delhi High Court in the case of Hyosung Corporation v. AAR [2016] 382 ITR 371 (Del) is misplaced as in that case the issue was regarding procedure of filing a petition before the AAR, where the matter was pending before any Income-tax Authority and had nothing to do with the issue in the instant case.

CIT v. Herbalife International India Pvt Ltd. [2016] 384 ITR 276 (Del)

For further details, please refer to our Flash News dated 3 August 2016 available at this link

Group reorganisation

Transfer of shares of an Indian company by a Mauritius based company to a Singapore based company under group reorganisation is not taxable under the India-Mauritius tax treaty and it is not a tax avoidant transaction

The applicant, a company, incorporated and registered in Mauritius, is a tax resident of Mauritius. The applicant is part of Dow group of companies (the Group). The applicant received the Tax Residency Certificate (TRC) in Mauritius. Dow AgroSciences India Private Limited (DAS India) is a part of Dow Group. DAS India is engaged in manufacturing and trading of pesticides and insecticides. The applicant is a holding company of DAS India and had acquired shares of DAS India during the period 1995 to 2005. The applicant proposes to contribute shares held in Dow India as its capital in DAS Singapore. By virtue of this, DAS India would become 100 per cent subsidiary of DAS Singapore. The value of DAS Singapore's shares recorded in the books of DAS Mauritius would be considered as the sales consideration for the transfer of shares of DAS India.

AAR's ruling

Not a scheme to avoid payment of taxes in India

This transaction began almost 20 years back hence, could not have been a scheme to avoid the payment of taxes. The investment made in the DAS India was with the prior approval of Department of Industrial Policy & Promotion (DIPP). The subsequent investment also was with the approval of RBI and hence it cannot be said the shares were acquired with a view to selling in future through the Mauritius company and thus to avoid the taxes on possible capital gains. The shares were acquired at a substantial cost of about INR610 million and if they are sought to be now transferred to a Singapore concern which is the own subsidiary of the applicant, it cannot amount to a design or a scheme to avoid payment of taxes in India. All this exercise is also more than five years old from the date of the last acquisition of the shares.

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No PE in India

The applicant has produced a TRC from Mauritius. It does not have an office, employees or agents in India. Accordingly, the applicant does not have a PE in India.

Business income v. Capital gains

It has been held that the shares held in DAS India would be in the nature of the capital asset under Section 2(14) of the Act and therefore, income from transfer of these shares cannot be treated as a business income.

Capital gains not taxable in India

Provisions of Article 13(1) and (3) of the India-Mauritius tax treaty are not applicable in the present case. Further, considering the nature of the assets (equity shares in an Indian Company) being transferred, even Article 13(2) of the tax treaty will also not be applicable since the applicant does not have a PE in India. There would be no taxation on the capital gains arising from the proposed transfer of shares of DAS India by the applicant to the DAS Singapore.

MAT provisions do not apply

Central Board of Direct Taxes (CBDT) Instruction No. 9/2015 dated 2 September 2015 mentions that the Foreign Institutional Investors (FIIs)/Foreign Portfolio Investors (FPIs) having no PE/place of business in India would not be covered by Section 115JB of the Act. In the present case since the applicant does not have a PE in India, there will be no applicability of Section 115JB to the applicant.

Transfer pricing provisions do not apply

Unless the transaction is taxable in India, transfer pricing provisions would not apply. Section 92 of the Act is not an independent charging section and would be applicable only if there is any chargeable income arising from the international transaction. Even though the proposed transfer of shares could result in income/capital gain from the international transaction since this income is not chargeable to tax in India in accordance with Article 13 of the tax treaty, Section 92 to 92F of the Act will not be applicable.

No withholding of tax under Section 195

The capital gains earned out of proposed transaction are not taxable, and therefore, Section 195 of the Act shall not be applicable.

No requirement to file return of income

In view of the binding Federal Court's decision in the case of Chatturam v. CIT [1947] 15 ITR 302 (FC), the applicant is not required to file any return of income.

Dow AgroSciences Agricultural Products Ltd. [2015] 65 taxmann.com 245 (AAR)

For further details, please refer to our Flash News dated 27 January 2016 available at this link

Capital gain arising on transfer of shares of an Indian company is not taxable under the India-Mauritius tax treaty

The applicant's shares are held by Mahindra Overseas Investment Co. (Mauritius) Limited, a company incorporated in Mauritius and BT Holding Limited, a company incorporated in the United Kingdom in the ratio of 57:43. The applicant's board of directors comprises of three directors resident in Mauritius, one director resident in the United Kingdom and one director resident in India. The control and management of affairs of the applicant is exercised by the board of directors whose meetings were conducted in and chaired in Mauritius.

Mahindra & Mahindra Ltd. (M&M), a company incorporated in India and British Telecommunication PLC (BT), a company incorporated in England entered into a joint venture agreement to form Mahindra British Telecom Ltd. (now known as Tech Mahindra Limited (TML) on 19 August 1986.

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The shares of TML were held by M&M and BT in the proportion of 57:43.

TML and SBC services (now known as AT&T) entered into a commercial agreement on 28 December 2004. The applicant was incorporated in Mauritius on 9 May 2005. The applicant had acquired 8 per cent holding in TML which is listed on Bombay Stock Exchange and National Stock Exchange in India. The shares were acquired in two tranches in financial years 2005-06 and 2006-07. An agreement was entered into between TML and the applicant on 23 June 2005 wherein the applicant agreed to subscribe and invest in TML on a partly paid basis. The applicant agreed to subscribe 99,31,638 equity shares at a price of INR67 per share.

A multiparty agreement named as 'Option Agreement' was executed between AT&T, M&M, BT, TML and the applicant on 10 May 2005. As per the Option Agreement, AT&T will be granted options over the shares representing 8 per cent of the enlarged fully diluted shares of TML upon achieving certain specified milestones. AT&T achieved the milestones and decided to exercise the option. The applicant consequently transferred 98,70,912 shares of TML to AT&T at USD3.5022 per share and realised long-term capital gain of INR900 million.

In the instant case, earlier the AAR had held that it is not bound to give a ruling on the said transactions intended to circumvent Securities Exchange Board of India (SEBI) guidelines issued in public interest. The matter was taken to the Bombay High Court by the applicant. The High Court noted that the agreement entered into in 2004 between TML and AT&T was not acted upon due to commercial reasons and that the draft prospectus filed with the SEBI in 2006 had disclosed the agreement entered into by the applicant with AT&T. The High Court restored the questions to the AAR for a ruling holding that there had been no breach of SEBI guidelines and SEBI had not issued any show cause notice or adjudication order for contravention of its guidelines.

The AAR held that the tax department's emphasis on the fact that the applicant was not set up for a commercial purpose and was holding shares only for ultimately transferring the same to AT&T is misplaced. With an objective to motivate AT&T to give business to TML, it was agreed commercially between the applicant, TML and AT&T that AT&T would be offered an opportunity to become a shareholder of TML only when it had given a certain level of business to TML for which certain milestones were set. It was only after such milestones were achieved that the option was exercised. There is nothing unusual or abnormal about such conditions in an Option Agreement.

On perusal of minutes of the board meetings held in Mauritius relating to buy-back of shares, final closing for sale of shares held in TML, appointment of tax advisor, approval of financial statements, dividend declaration and distribution, etc. indicate that the control and management of the affairs of the company particularly all financial affairs were situated only in Mauritius. The Supreme Court in the case of V.VR.N.M. Subbayya Chettiar vs CIT [1951] 19 ITR 168 (SC) held that the term affairs must mean affairs which are relevant for the purpose of the Act and which have some relation to income. There is no substantial evidence to show that any important affairs of the applicant relevant for the purpose of the Act were being controlled from India. AAR placed reliance on the decision of CIT vs Nandlal Gandalal [1960] 40 ITR 1 (SC) wherein the Supreme Court held that the expression 'control and management' means de facto control and management and not merely the right or power to control and manage. There is no force in the argument that since the real transaction was between TML and AT&T, the control and management of the applicant should be treated as in India. Accordingly, it was held that capital gain arising on transfer of shares of an Indian company is not taxable under the India-Mauritius tax treaty.

Mahindra-BT Investment Company (Mauritius) Limited [2012] 210 Taxman 638 (AAR)

For further details, please refer to our Flash News dated 16 September 2016 available at this link

Disallowance under Section 14A

The Bombay High Court's decision on Section 14A of the Act and the binding precedent

In the instant case, the Bombay High Court dealt with an issue of disallowance under Section 14A of the Act of interest paid on borrowed funds in respect of investments made in tax free securities

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when the taxpayer had own funds in excess of investments. The High Court referred to the taxpayer's case of earlier years and observed that the presumption with regard to investment in tax-free securities coming out of the taxpayer's own funds, in case the same are in excess of the investments made in the securities, applies to Section 14A of the Act.

The High Court observed that the Mumbai Tribunal is bound to follow the jurisdictional High Court decision on the issue which was concluded in the taxpayer's own case for earlier years. The decision in the case of Godrej and Boyce Manufacturing Co. Ltd v. DCIT [2010] 328 ITR 81 (Bom) is not a precedent for the issue in the instant case and could not be relied upon to disregard the binding decision in the case of the taxpayer's own case for the earlier year. The decision of the High Court is binding upon all authorities and Tribunals functioning within the state.

HDFC Bank Ltd. Mumbai v. DCIT [2016] 383 ITR 529 (Bom)

For further details, please refer to our Flash News dated 14 March 2016 available at this link

Minimum Alternate Tax

A tax officer does not have the power to recompute the book profit under minimum alternate tax provisions and has to rely upon the accounts scrutinised and certified by the statutory auditors

The taxpayer was incorporated on 3 February 1992 with an objective to commence the business of running a hotel. It had purchased land at Mahadevapura through public auction from the appropriate authority of the tax department for INR2.6 million. The taxpayer borrowed an unsecured loan of INR2.4 million from its directors for meeting the purchase consideration of the land. The taxpayer could not commence the hotel project on the said land, and therefore, sold the land for INR12.25 million on 23 January 2003. In the books of account of the taxpayer, the loan was capitalised during the financial year which ended on 31 March 2003. The taxpayer booked a capital gain of INR5.17 million arising out of the sale of the land directly to the capital reserve and not to the profit and loss account. The AO held that the capital gains ought to have been included in the profit and loss account, according to the accounting standard referred to by him in the assessment order and hence, arrived at a conclusion that the profit shown in the profit and loss account should be increased by the amount of capital gain of INR5.17 million. The CIT(A) held that capital gains should be included for the purpose of computing book profit. The Bangalore Tribunal confirmed the order passed by the CIT(A).

High Court ruling

The Supreme Court in the case of Apollo Tyres Ltd. v. CIT [2002] 255 ITR 273 (SC) held that the AO while computing the income under Section 115J of the Act has only the power of examining whether the books of account are certified by the authorities under the Companies Act, 1956. The AO thereafter has the limited power of making increases and reductions as provided for in the Explanation to the said section. Subsequently, the Supreme Court in the case of CIT v. HCL Comnet Systems & Services Ltd. [2008] 305 ITR 409 (SC) held that the adjustment required to be made to the net profit disclosed in the profit and loss account for the purpose of Section 349 of the Companies Act are quite different from the adjustment required to be made under the Section 115JA of the Act. For the purpose of Section 115JA of the Act, the AO can increase the net profit determined as per the profit and loss account prepared as per Parts II and III of Schedule VI to the Companies Act only to the extent permissible under the Explanation to Section 115JA of the Act.

The Explanation appended to Section 115JB of the Act provides certain items which if debited to the profit and loss account can be added back to the net profit for computing the book profit. Clause (b) of the said Explanation provides for the amount carried to any reserves by whatever name called. In the present case, the capital gains were directly accounted to a capital reserve without taking the said amount to the profit and loss account, therefore, said Explanation to Section 115JB of the Act is not applicable to the facts of the present case.

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In view of above, the AO has no power to recompute the book profit and has to rely upon the authentic statements of account of the company, the accounts being scrutinised and certified by the statutory auditors though with a qualification, approved by the company in a general body meeting and thereafter filed before the ROC, who has a statutory obligation to examine and be satisfied that the accounts of the company are maintained in accordance with the requirements of the Companies Act. Accordingly, the High Court allowed the appeal in favour of the taxpayer.

Sri Hariram Hotels (P.) Ltd. v. CIT [2016] 66 taxmann.com 233 (Kar)

For further details, please refer to our Flash News dated 26 February 2016 available at this link

Other direct tax developments

Services provided by the Bombay Stock Exchange to transact a business of sale and purchase of shares do not amount to FTS

The Bombay High Court had held that the transaction charges paid by a member of the Bombay Stock Exchange (BSE) to transact a business of sale and purchase of shares amounts to a payment of FTS. On such payments, tax was deductible at source under Section 194J of the Act. Since tax was not deducted at source, transaction charges paid by the taxpayer were disallowed under Section 40(a)(ia) of the Act

The Supreme Court held that services provided by the BSE to transact a business of sale and purchase of shares do not amount to FTS. The Supreme Court observed that the services provided failed the test of a specialised, exclusive and individual requirement of the user. In the absence of the same, the service, though rendered, would be merely in the nature of a facility offered. Therefore, such services are not FTS under Section 9(1)(vii) of the Act and tax is not required to be deducted under Section 194J of the Act.

CIT v. Kotak Securities Ltd. [2016] 383 ITR 1 (SC)

For further details, please refer to our Flash News dated 31 March 2016 available at this link

Income accrue or arise only when a right to receive the amount is vested in the taxpayer

The premises belonging to the taxpayer was let out on rent to the Government of India. The rent was enhanced with retrospective effect from 1 September 1987 vide a letter dated 29 March 1994 of the Estate Manager of the Government of India. The said letter provides that the enhancement was subject to conditions including execution of a fresh lease agreement and communication of acceptance of the conditions incorporated therein. Such acceptance was communicated by the taxpayer by letter dated 30 March 1994.

The taxpayer relying on the decision of the Supreme Court in the case of E.D. Sassoon & Company Ltd[2] contended that no income accrued or arose and no annual value which is taxable under Sections 22 and 23 of the Act was received or receivable during AY 1989-1990. The tax department contended that the enhancement of rent is with retrospective effect from 1 September 1987 and, therefore, the income must have to be understood to have been received in the said AY i.e. 1989-1990. Accordingly, the tax department issued a notice under Section 148 of the Act seeking to reopen the concluded assessment.

Supreme Court ruling

The Supreme Court in the case of E.D. Sassoon & Company Ltd. has held that income can be said to have accrued or arisen only when a right to receive the amount in question is vested in the taxpayer. In the present case, no such right to receive the rent has accrued to the taxpayer at any point of time during the AY in question, in as much as such enhancement though with retrospective

[2] E.D. Sassoon & Company Ltd. And Others v. CIT [1954] 26 ITR 27 (SC)

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effect, was made only in the year 1994.

The tax department's contention that the enhancement was with retrospective effect, does not alter the situation as retrospectivity is with regard to the right to receive rent with effect from an anterior date. The right, however, came to be vested only in the year 1994.

Accordingly, it has been held that the notice seeking to reopen the assessment for the AY 1989-1990 is without jurisdiction and authority of law.

P.G. & W. Sawoo (P.) Ltd. v. ACIT [2016] 385 ITR 60 (SC)

For further details, please refer to our Flash News dated 11 May 2016 available at this link

CBDT notifies rules for computation of fair market value and reporting requirements in relation to indirect transfer provisions

Section 9(1)(i) of the Act provides that if any share or interest in a foreign company or entity derives its value substantially from the assets located in India, then such share or interest is deemed to be situated in India. Thereby, any income arising from the transfer of such share or interest is deemed to accrue or arise in India.

The share or interest is said to derive its value substantially from assets located in India if the Fair Market Value (FMV) of assets located in India comprise at least 50 per cent of the FMV of total assets of the company or entity. Further, Section 285A of the Act mandates reporting requirement on the Indian concern through or in which the foreign company or entity holds the assets in India. Rules with respect to computation of FMV of Indian and global assets were required to be prescribed. Further, the information to be furnished and manner of furnishing the same were also required to be prescribed.

On 23 May 2016, the CBDT has issued draft rules[3] to prescribe the manner of computation of FMV of assets of the foreign company or entity and the reporting requirements by the Indian concern through the amendments of the Income-tax Rules, 1962. Draft forms for reporting requirements have also been prescribed. The CBDT had invited comments and suggestions from stakeholders and the general public on the draft rules and forms.

On 28 June 2016, the CBDT notified the rules and forms.

CBDT Notification 55/2016, dated 28 June 2016

For further details, please refer to our Flash News dated 30 June 2016 available at this link

CBDT notifies final rules with respect to buy-back of shares

Section 115QA of the Act provides for levy of additional income tax at the rate of 20 per cent of the distributed income on account of buy-back of unlisted shares by a company. Section 115QA of the Act defines distributed income as consideration paid by the company on buy-back of shares as reduced by the amount, which was received by the company for issue of such shares. There are different situations in which shares can be issued. For example, shares issued in different tranches, for different consideration, at different point of time or may have been issued in lieu of existing shares of another company under amalgamation, merger or demerger. Concerns were raised regarding lack of clarity in determination of consideration received by the company at the time of issue of shares being bought back by the company.

The Finance Act, 2016 amended to Section 115QA of the Act to provide that for the purpose of computing distributed income, the amount received by the company in respect of shares being bought back shall be determined in the prescribed manner.

[3] F No. 142/26/2015-TPL, dated 23 May 2016

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On 25 July 2016, the CBDT issued draft rules to prescribe the methodology for determination of the amount received by the companies under different circumstances in which the shares have been issued. CBDT had invited comments and suggestions from stakeholders and the general public on the draft rules.

Pursuant to comments received from the stakeholders, CBDT has notified final rules for buy-back of shares. The rules have come into effect from 1 June 2016.

CBDT Notification No. 94/2016, dated 17 October 2016

For further details, please refer to our Flash News dated 30 June 2016 available at this link

India and Mauritius sign a protocol amending the India-Mauritius tax treaty

On 10 May 2016, India and Mauritius has signed a protocol amending the India-Mauritius tax treaty at Mauritius. The key features of the protocol are as under:

Gains from the alienation of shares acquired on or after 1 April 2017 in a company which is a resident of a state may be taxed in that state. In other words, gains from transfer of shares of an Indian resident company may be taxed in India. The tax rate on such capital gains arising during the period from 1 April 2017 to 31 March 2019 shall not exceed 50 per cent of the tax rate applicable on such gains in the state of residence of the company whose shares are being alienated.

- A Limitation of Benefit (LOB) clause has been introduced which provides that a resident of a state shall not be entitled to the benefits of 50 per cent of the tax rate applicable in transition period (1 April 2017 to 31 March 2019) if its affairs were arranged with the primary purpose to take advantage of such benefits.
- The service PE clause has been introduced in the India-Mauritius tax treaty.
- The existing tax treaty does not have FTS related article. The protocol has introduced FTS article. FTS has been defined to mean payments of any kind (other than those mentioned in Articles 14 and 15) as consideration for managerial or technical or consultancy services, including the provision of services of technical or other personnel.
- Interest may also be taxed in the state in which it arises, and according to the laws of that state, but if the beneficial owner of the interest is a resident of the other state, the tax so charged shall not exceed 7.5 per cent of the gross amount of the interest. Further, interest arising in a state shall be exempt from tax in that state provided it is derived and beneficially owned by any bank, resident of the other state carrying on bona fide banking business. However, this exemption shall apply only if such interest arises from debt claims existing on or before 31 March 2017.
- The existing tax treaty gives the right to the resident state to tax other income. However, the protocol provides that other income of a resident of a state may also be taxed in the source state.

Source - http://mof.govmu.org, 12 May 2016

For further details, please refer to our Flash News dated 13 May 2016 available at this link

CBDT notifies Equalisation Levy Rules, 2016

The Finance Act, 2016 has introduced an ‘Equalisation Levy’ in line with the recommendation of the OECD Base Erosion and Profit Shifting (BEPS) project to tax e-commerce transactions. The Act provides that the Equalisation levy is to be charged on specified services (online advertising, provision of digital advertising space, etc.) at 6 per cent of the amount of consideration for specified services received or receivable by a non-resident payee not having a PE in India.

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The CBDT has now issued the Equalisation Levy Rules, 2016 to lay down the compliance procedure to be followed for such levy. The Rules will come into force from 1 June 2016.

Key summary of the rules is as follows:

- Equalisation Levy is to be deducted and paid to credit of central government by remitting to Reserve Bank of India or in any branch of the State Bank of India or any authorised bank accompanies by an equalisation challan.
- The deductors of Equalisation Levy during a financial year are required to furnish a 'Statement of specified services' in Form 1, electronically (either digital signature or verification code), on or before 30 June immediately following that financial year.
- Rules prescribe the process for issuance of notice by the AO in the event of non-furnishing of Form 1 by the deductors.
- Rules also prescribe various forms – Form 2 for notice of demand by the AO; Form 3 for filing appeal before CIT(A); Form 4 for filing appeal before the Income Tax Appellate Tribunal.

Notification No. 37 and 38/2016, dated 27 May 2016

For further details, please refer to our Flash News dated 30 May 2016 available at this link

CBDT notifies Foreign Tax Credit rules

The CBDT vide Notification 54/2016, introduced a new rule with respect to the Foreign Tax Credit (FTC) that shall come into effect from 1 April 2017. The new FTC rules are as follows:

- The resident taxpayer shall be allowed FTC of any foreign tax paid in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India.
- In a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.
- The FTC shall be available against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty.
- FTC shall not be available in respect of any amount of foreign tax or part thereof which is disputed by the taxpayer.
- The credit of disputed tax shall be allowed for the year in which such income is offered to tax or assessed to tax in India if the taxpayer within six months from the end of the month in which the dispute is finally settled, furnishes evidence of settlement of dispute and an evidence to the effect that the liability for payment of such foreign tax has been discharged by him/her and furnishes an undertaking that no refund in respect of such amount has directly or indirectly been claimed or shall be claimed.
- The FTC shall be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country or specified territory and given effect to in the following manner:
  - The FTC shall be the lower of the tax payable under the Act on such income and the foreign tax paid on such income. However, in case the foreign tax paid exceeds the amount of tax payable in accordance with the tax treaty, such excess shall be ignored
  - The FTC shall be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.
  - In the case where any tax is payable under the provisions of Minimum Alternate Tax (MAT) or Alternate Minimum Tax (AMT) under the Act, the credit of foreign tax shall be allowed against

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such tax in the same manner as is allowable against any tax payable under the provisions of the Act.

- Where the amount of FTC available against the tax payable under the provisions of MAT, exceeds the amount of tax credit available against the normal provisions, then while computing the amount of MAT credit in respect of the taxes paid under MAT provisions, as the case may be, such excess shall be ignored.
- The FTC shall not be allowed unless the specified documents are furnished by the taxpayer.

Notification No. 54/2016, dated 27 June 2016

For further details, please refer to our Flash News dated 30 June 2016 available at this link

CBDT amends General Anti-avoidance Rules

The CBDT vide Notification No. 49/2016 amended the General Anti-avoidance Rules (GAAR) rules. The amended rules are as follows:

- As per Rule 10U(1)(d), the GAAR provisions are not applicable to any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from transfer of investment made before the 30 August 2010. The date of 30 August 2010 has been substituted with 1 April 2017.
- As per Rule 10U(2), the GAAR provisions are applicable to any arrangement, irrespective of the date on which it has been entered into, in respect of the tax benefit obtained from an arrangement or after 1 April 2015. The date of 1 April 2015 has been substituted with 1 April 2017.

www.taxguru.in

For further details, please refer to our Flash News dated 24 June 2016 available at this link

CBDT clarifies the India-U.K. tax treaty benefits available to U.K. partnership firms

In February 2014, the protocol to the India-U.K. tax treaty amended the definition of the term 'person' to delete the exclusion of U.K. partnership firms. Further, the term 'resident' was amended to include partnership firms, estates or trusts as a resident of a contracting state

to the extent the income of such partnership firms, estates or trusts is subject to the tax in that state as the income of a resident, either in its hands or in the hands of its partners or beneficiaries. Certain apprehensions that the term 'person' in the tax treaty does not specifically include partnerships, have been brought to the notice of the CBDT. Accordingly, clarity was sought from the CBDT on whether the provisions of the tax treaty were applicable to a partnership firm.

The CBDT vide Circular No. 2/2016 clarified that the provisions of the tax treaty would be applicable to a partnership that is a resident of either India or the U.K., to the extent that the income derived by such partnerships, estates or trusts is subject to tax in that state as the income of a resident, either in its hands or in the hands of its partners or beneficiaries.

Circular No. 2/2016, dated 25 February 2016

For further details, please refer to our Flash News dated 7 March 2016 available at this link

CBDT clarification on taxability of consortium members in the case of EPC contracts and turnkey projects

The CBDT vide Circular 7/2016 clarified that a consortium arrangement for executing EPC/turnkey contracts which have the following attributes, may not be treated as an Association of Persons (AOP):

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- Where each member is independently responsible for executing its part of the work through its own resources and also bears the risk of its scope of work i.e. there is a clear demarcation in the work and costs between the consortium members and each member incurs expenditure only in its specified area of work
- Each member earns profit or incurs losses based on the performance of the contract, falling strictly within its scope of work. However, consortium members may share contract price at a gross level only to facilitate convenience in billing
- Men and materials used for any area of work are under the risk and control of the respective consortium members
- Control and management of the consortium are not unified, and common management is only for the interse coordination between the consortium members for administrative convenience.

The CBDT also clarifies that there may be other additional factors which may justify that a consortium is not an AOP, and that the same shall depend upon the facts and circumstances of a particular case, which needs to be taken into consideration while taking a view in the matter.

Further, this Circular shall not apply where all or some of the members of a consortium are Associated Enterprises (AEs) under Section 92A of the Act. In such cases, the AO shall decide whether an AOP is formed or not, keeping in view the relevant provisions of the Act and judicial precedents on the issue.

Circular No. 07/2016, dated 7 March 2016

For further details, please refer to our Flash News dated 8 March 2016 available at this link

CBDT notifies rules with respect to non-furnishing of PAN by non-residents and furnishing of alternative documents

The CBDT introduced Rule 37BC in the Rules in relation to relaxation from deduction of tax at source at a higher rate under Section 206AA of the Act. Rule 37BC of the Rules provides that a non-resident deductee without a PAN, shall not be subject to higher withholding tax under Section 206AA, in respect of payments in the nature of interest, royalty, FTS and payments on transfer of any capital asset, if the deductee furnishes the specified details and the documents to the deductor. The Rule is summarised as follows:

- As per Rule 37BC(1), in the case of a non-resident, not being a company, or a foreign company (the deductee) and not having PAN, the provisions of Section 206AA shall not apply in respect of payments in the nature of interest, royalty, FTS and payments on transfer of any capital asset, if the deductee furnishes the details and the documents specified in sub-rule (2) to the deductor.
- Rule 37BC(2) specifies that in respect of payments specified therein the deductee shall furnish the following details and documents to the deductor:
  - name, e-mail id, contact number;
  - address in the country or specified territory outside India of which the deductee is a resident;
  - a certificate of his being resident in any country or specified territory outside India from the government of that country or specified territory, if its law provides for the issuance of such certificate;
  - Tax Identification Number of the deductee in the country or specified territory of his residence. In case no such number is available, then a unique number on the basis of which the deductee is identified by the government of that country or the specified territory of which he claims to be a resident.
- Consequential changes have been introduced in Form No. 27Q, which is a quarterly statement of deduction of tax under Section 200(3) of the Act, in respect of specified payments. Accordingly, the information mentioned in the Rule 37BC needs to be furnished in the Form No.

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27Q.

CBDT Notification No. 53 /2016, F.No.370 142/16/2016-TPL, dated 24 June 2016

For further details, please refer to our Flash News dated 29 June 2016 available at this link

CBDT notifies amendments to Rule 8D of Income-tax Rules

The CBDT vide Notification No. 43/2016 amended Rule 8D of the Rules. The erstwhile sub-rule (2) to Rule 8D provided for computing the expenditure in relation to earning of exempt income as an aggregate of the following:

- expenses directly incurred to earn exempt income;
- interest expenditure incurred by the taxpayer (not directly attributable to any particular income) computed as a proportion of the average value of investment earning exempt income to average total assets; and
- 0.5 per cent of the average value of investment income from which is exempt.

The CBDT amended the formula for computing the expenditure relatable to earning of exempt income contained in Rule 8D. The amendment has done away with the inclusion of proportionate indirect expenses in computing the expenditure relatable to earning exempt income, as against the earlier formula. However, the new formula provides for aggregation of expenses directly identifiable to earning exempt income with a value computed at a presumptive rate of 1 per cent (as against earlier 0.5 per cent) to be applied to the annual average of monthly averages of the value of investments. The new rule further provides for an overall capping on the disallowance to the total expenditure claimed by the taxpayer.

This amendment has come into force on 2 June 2016[4].

Notification No. 43/2016 [F.No.. 370142/7/2016-TPL] dated 2 June 2016

For further details, please refer to our dated Flash News dated 27 June 2016 available at this link

India and Singapore sign a protocol amending the tax treaty

The Government of India has signed the third protocol with Singapore to amend the India-Singapore tax treaty which is in line with India's treaty policy to prevent double non-taxation, curb revenue loss and check the menace of black money through AEOI as reflected in India's recently revised tax treaties with Mauritius and Cyprus and the joint declaration signed with Switzerland. Key aspects of the press release are as follows:

- The Third Protocol amends the tax treaty with effect from 1 April 2017 to provide for source based taxation of capital gains arising on transfer of shares in a company.
- In order to provide certainty to investors, investments in shares made before 1 April 2017 have been grandfathered subject to fulfilment of conditions in LOB clause as per 2005 Protocol. Further, a two year transition period from 1 April 2017 to 31 March 2019 has been provided during which capital gains on shares will be taxed in source country at half of normal tax rate, subject to fulfilment of conditions in LOB clause.
- The Third Protocol also introduces provisions to facilitate relieving of economic double taxation in transfer pricing cases which is in line with India's commitments under Base Erosion and Profit Shifting (BEPS) Action Plan to meet the minimum standard of providing Mutual Agreement Procedure (MAP) access in transfer pricing cases.
- The Protocol also updates Article 9 on AEs to provide for both countries to enter into bilateral discussions for elimination of double taxation arising from transfer pricing or pricing of related

[4] The date of its publication in official gazette

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party transactions.

- The Protocol also enables application of domestic law and measures concerning prevention of tax avoidance or tax evasion.

Source: Taxsutra.com

For further details, please refer to our Flash News dated 31 December 2016 available at this link

Key highlights of the revised India-Cyprus tax treaty

India has signed a revised tax treaty with Cyprus along with its Protocol. Key aspects of the revised tax treaty are summarised as follows:

- The revised tax treaty provides for source based taxation of capital gains arising from alienation of shares, instead of residence based taxation provided under the existing tax treaty. However, a grandfathering clause has been provided for investments made prior to 1 April 2017, in respect of which capital gains would continue to be taxed in the country of which taxpayer is a resident.
- The revised tax treaty expands the scope of PE and reduces the tax rate on royalty in the country from which payments are made to 10 per cent from the existing rate of 15 per cent, in line with the tax rate under Indian tax laws.
- The revised tax treaty provides for assistance between the two countries for collection of taxes. The revised tax treaty also updates the provisions related to exchange of information to accepted international standards, which will enable exchange of banking information and allow the use of such information for purposes other than taxation with the prior approval of the competent authorities of the country providing the information.
- It also updates the text of other provisions in accordance with the international standards and consistent policy of India in respect of tax treaties.
- The provisions of revised tax treaty will enter into force after the completion of necessary internal procedures in both countries and is expected to come into effect in India in respect of income derived in fiscal years beginning on or after 1 April 2017.

Source – India-Cyprus tax treaty issued by Cyprus government

For further details, please refer to our Flash News dated 16 September 2016 available at this link

CBDT issues press release to reduce deemed profit rate for eligible business under Section 44AD of the Act who will accept payments through digital mode

Section 44AD of the Act provides that the taxpayer engaged in any eligible business[5] and having a turnover of INR2 crore or less, the profit is deemed to be 8 per cent of the total turnover or gross receipts.

On 19 December 2016, the CBDT issued a press release stating that in order to achieve the government's mission of moving towards a less cash economy and to incentivise small traders/businesses to proactively accept payments by digital means, it has been decided to reduce the existing rate of deemed profit of 8 per cent under Section 44AD of the Act to 6 per cent in respect of the amount of total turnover or gross receipts received through banking channel/digital means for the Financial Year (FY) 2016-17. However, the existing rate of deemed profit of 8 per cent referred to in Section 44AD of the Act, shall continue to apply in respect of total turnover or gross receipts received in cash. Legislative amendment in this regard shall be carried out through

[5] Eligible business means –
(i) any business except the business of plying, hiring or leasing goods carriages referred to in Section 44AE; and
(ii) whose total turnover or gross receipts in the previous year does not exceed an amount of two crore rupees.

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the Finance Bill, 2017.

CBDT press release, dated 19 December 2016

For further details, please refer to our Flash News dated 20 December 2016 available at this link

Transfer pricing

Budget 2016 - Transfer Pricing Amendments

One of the most important developments from a Transfer Pricing (TP) regulations perspective was introduction of three-tier TP documentation norms with effect from AY 2017-18.

Master file and local file

The Memorandum to the Finance Bill (Memorandum) states that a master file will have to be maintained and the detailed rules regarding the same will be notified at a later date. However, no threshold for preparation of master file has been prescribed. Local file related regulations that already exist in the law may continue or may be aligned to the OECD Base Erosion and Profit Shifting Action 13 recommendations, however the same will be clear only once the detailed Rules in this regard are issued.

Country-by-Country (CbyC) reporting

A new Section 286 of the Act on CbyC reporting has been introduced. These provisions require the Indian Parent entity of an international multinational group or any other designated group entity in India (referred to as alternate reporting entity) to file a CbyC report for financial year 2016-17 before the due date of filing of return of income i.e. 30 November 2017. The threshold for filing the CbyC report has been maintained at EUR750 million (as per the Memorandum). The detailed format shall be notified in the Rules at a later date. However, it is proposed in the memorandum that the OECD prescribed template will be adopted.

The CbyC report will be required to furnish the following details:

- Aggregate information in respect of the amount of revenue, profit or loss before income-tax, income-tax paid and accrued, stated capital, accumulated earnings, number of employees and tangible assets not being cash or cash equivalents, with regard to each country in which the group operates;
- Details of each constituent entity of the group including the country in which such constituent entity is incorporated or organised or established and the country where it is resident;
- Nature and details of the main business activity or activities of each constituent entity.

The key highlights of the proposed CbyC reporting provisions are as follows:

- CbyC report will have to be furnished by the local constituent Indian entity,
  - if the parent entity is resident of a country with which India does not have an agreement providing for exchange of information under the CbyC report; or
  - there has been a systemic failure of that country.
- Where there are more than one constituent entities of the international group, resident in India, the CbyC report shall be furnished by any one constituent entity, if the international group has designated such entity to furnish the CbyC report (information to be conveyed in writing to the prescribed Indian tax authorities).
- If any other alternate reporting entity of the international group has furnished the CbyC report with the tax authority of their country, there will be no need for the local constituent entity to furnish the same again locally, if the following conditions are satisfied:

  a) the CbyC report is required to be furnished under the local law of that country;

  b) that country has entered into an agreement with India providing for exchange of the CbyC

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report in respect of the international group;

c) that country's prescribed authority has not conveyed any systemic failure in respect of the said country to any constituent entity resident in India;

d) the said country or territory has been informed in writing by the constituent entity that it is the alternate reporting entity on behalf of the international group.

Penalty provisions relating to transfer pricing documentation

- Failure to furnish information and documentation under the proposed three-tier documentation structure by the due date will be INR500,000 (approx. USD7500).
- Stringent penalties have also been proposed for failure to furnish CbyC report by the prescribed due date, failure to information/documents sought by the prescribed authorities and in case of inaccurate information being filed as part of the CbyC report.
- Pursuant to a TP adjustment, following specific penalty provisions have been proposed in situations wherein the tax payer has failed to maintain appropriate documentation or failed to disclose international transaction:
  - Penalty at 50 per cent of the tax payable on under-reported transaction
  - Penalty at 200 per cent of the tax payable on misreporting of transaction

Administrative TP proposals

- Time limit for completion of TP audits has been reduced by three months.
- Revenue authorities will have no right to appeal against the instructions issued by the DRP.
- Where the time limit for completion of assessment proceedings is stayed (i) by an order/ injunction of any court (ii) to obtain information under the agreement referred in Section 90 or 90A of the Act, the period for completion of assessment proceedings by the Transfer Pricing Officer (TPO), subsequent to such stay shall be minimum 60 days.

Union Budget 2016 presented on 29 February 2016

For further details please refer to our Flash News dated 01 March 2016 available at this link

CBDT replaces guidelines for selection and referral of TP cases for assessment

The CBDT issued Instruction No. 3/2016 replacing Instruction No. 15 dated 16 October 2015, regarding the 'Guidelines for Implementation of TP Provisions'. It has reiterated and prescribed an additional mandatory criteria to select specialised TP scrutiny cases and clarified the role of AOs and TPOs.

Reference to the TPO

The CBDT has decided that the AO shall henceforth make a mandatory reference to the TPO only under the following circumstances:

- All cases selected for scrutiny on the basis of TP risk parameters either under the
  - Computer assisted scrutiny selection system or
  - Compulsory manual selection system in accordance with the CBDT's annual instructions[6]
- Cases selected for scrutiny on non-TP risk parameters shall be referred to TPOs only in the following circumstances:
  - the taxpayer has either not filed the Accountant's Report under Section 92E of the Act or has not disclosed an international transaction or specified domestic transactions (SDTs) or both in the Accountant's Report;

[6] Instruction No. 6/2014 for selection in F.Y 2014-15 and Instruction No. 8/2015 for selection in F.Y 2015-16

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- there has been a TP adjustment of INR10 crore or more in an earlier AY and such an adjustment has been upheld by the judicial authorities or is pending in appeal; and
- where search and seizure or survey operations have been carried out and findings regarding TP issues have been recorded by the Investigation Wing or the AO.

- Cases involving a TP adjustment in an earlier AY that has been fully or partially set-aside by the Tribunal, High Court or Supreme Court on the issue of the said adjustment.
- The AO must, as a jurisdictional requirement, record the satisfaction that there is an income or potential of an income arising and/or being effected from an international transaction or SDT, where the taxpayer has either not filed the Accountant's Report or has not disclosed such transactions in the Accountant's Report or has reported the transaction with a qualifying remark that such a transaction does not impact the income of the taxpayer.
- It is imperative for the AO to ensure that all international transactions or SDTs are explicitly mentioned in the letter through which the reference is made to the TPO.
- The determination of ALP should not be carried out at all by the AO in a case where reference is not made to the TPO. AO must record in the assessment order that the TP issue has not been examined at all.

Role of the TPO

- The role of the TPO is limited to determine the ALP in respect of international transactions or SDTs referred to it by the AO.
- If any other international transactions come to the notice of the TPO during the course of the proceedings before him/her, then he/she is empowered to determine the ALP of such other international transactions also by virtue of Section 92CA(2A) and (2B) of the Act.
- The TPO must take into consideration all the relevant facts and data available, and shall determine the ALP and pass a speaking order after seeking the necessary approvals.
- The TPOs, being the Additional/Joint Commissioner of Income Tax (CIT) shall be assigned not more than 50 cases depending on the importance and complexity involved.
- TPO shall be responsible for conducting the compliance audit of APAs and perform a scrutiny for the cases referred to it by the AO with respect to taxpayers opting for the safe harbour provisions.

Role of the AO after determination of the ALP - The AO has to compute the total income of the assessee in conformity with the ALP determined by the TPO.

Maintenance of database - The CIT(TP) shall ensure the expeditious resolution of cases referred by the AO to the TPO in their respective jurisdictions and accurate records of the same will be maintained in a specified format and to use this database for determination of the ALP in identical/substantially identical cases.

Applicability - This instruction is applicable with immediate effect. Further, the references made to TPOs after the issuance of instruction no. 15/2015, which are not in conformity with this instruction, may be withdrawn by the concerned Principal CIT or CIT.

CBDT instruction No. 3/2016 dated 10 March 2016

For further details please refer to our Flash News dated 14 March 2016 available at this link

Overseas AEs selected as tested parties in light of the APA concluded for later year

The taxpayer is engaged in the business of manufacturing and sale of Active Pharmaceutical Ingredients (APIs) (bulk drug)/formulations (dosage forms). The overseas AEs act as distributors/secondary manufacturers for the products manufactured by the taxpayer. During AY 2008-09, the taxpayer entered into transactions with its AEs in the nature of sale of APIs and drug

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formulations apart from other transactions which were not questioned by the TPO. The taxpayer had benchmarked the impugned international transactions by considering overseas AEs as tested parties with Transactional Net Margin Method as the most appropriate method. The taxpayer selected regional comparables for benchmarking the margins earned by overseas AEs. The TPO rejected the selection of overseas AEs as the tested parties and tested the company-wide margins of the taxpayer while determining the ALP of the international transactions. The DRP upheld the TP adjustment made by the TPO.

Tribunal's ruling

- Observing the fact that Indian TP regulations do not provide any guidance on the concept of tested party, the Tribunal relied on international guidance.
- Taking cognizance of the APA entered by taxpayer, the Tribunal stated that principles laid down in APA by highest revenue authority (CBDT) for comparability analysis should be given highest sanctity. Witnessing the fact that the Functions, Asset and Risk analysis and nature of international transactions are identical, it was held that the APA must mandatorily be followed by TPO to determine the ALP of transactions for year under appeal.
- Relying on Rule 10MA, the Tribunal appreciated that even in the absence of rollback, the methodology accepted in the APA may be followed for an earlier year (not covered under the APA) if the facts and nature of international transactions remain the same.
- Distinguishing the earlier years' order in the taxpayer's own case, the Tribunal held that the benchmarking approach followed in the current year was different to that undertaken in AY 2004-05. It was also noted that in the order for AY 2004-05, it was held that least complex entities must be selected as tested parties, which the taxpayer has also argued extensively.
- The Tribunal held that the taxpayer has adduced reasonably comparative data based on regional benchmarking and that the TPO was incorrect in rejecting foreign AEs as tested parties. Reliance was also placed on various case laws[7] cited by the taxpayer wherein selection of overseas tested party has been upheld.
- Based on the above, the Tribunal held that overseas AEs should be considered as tested parties and that due weightage be given to the APA on other issues as well.

Ranbaxy Laboratories Limited vs ACIT (ITA No. 196/Del/2013)

For further details please refer to our Flash News dated 27 April 2016 available at this link

India has signed Multilateral Competent Authority agreement for the automatic exchange of Country-by-Country reports

To boost transparency by multinational enterprises (MNEs), India along with 5 other countries - Canada, Iceland, Israel, New Zealand and the People's Republic of China signed Multilateral Competent Authority agreement (MCAA) for the automatic exchange of Country-by-Country (CbyC) reports. The signing event took place in Beijing, China.

The MCAA allows all its signatories to bilaterally and automatically exchange CbyC reports with each other. It will help ensure that tax administrations obtain a complete understanding of the manner in which MNEs structure their operations, while also ensuring that the confidentiality of such information is safeguarded.

The total number of signatories to MCAA as on 07 December 2016 are 50.

http://www.oecd.org/

[7] Development Consultant Private Limited v. DCIT [2008] 115 TTJ 557 (Kol) and General Motors India Private Limited v. DCIT (ITA No. 3096/Ahd/2010)

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Two enterprises cannot be treated as AEs unless both the parameters laid down in Section 92A of the Act are fulfilled

The taxpayer is engaged in the business of manufacture and sale of ready-made garments. It is a licensee of the brand-name 'Jockey' for the exclusive manufacturing and marketing of Jockey's readymade garments under the license agreement with Jockey International Inc, U.S. (JII), the owner of the brand Jockey. The taxpayer owned the entire manufacturing facility, capital investment, employees and there was no participation of JII in the capital and management of the taxpayer. In consideration for granting the right to use the brand-name, the taxpayer paid consideration in the form of royalty at the rate of 5 per cent of the sales to JII. The Form 3CEB was filed by the taxpayer disclosing the payment of royalty transaction.

During the AY 2010-11, the taxpayer incurred expenditure on Advertisement, Marketing and product Promotion (AMP) to increase its sales. The TPO stated that the AMP expenditure incurred by the taxpayer was done on behalf of JII to promote their brand name and hence, such costs should have been recovered by the taxpayer from JII. The TPO categorized the said expenses as an international transaction in the nature of brand building and determined the ALP by applying Bright Line Method. The TPO proposed adjustment in relation to both royalty and AMP expenses.

Tribunal's ruling

The Bangalore Tribunal rejected TPO's view that the two enterprises (i.e. the taxpayer and JII) should be treated as AEs u/s 92A, considering the amendment made to Sec 92A(2) vide Finance Act, 2002 with effect from April 1, 2002 which provides that 'in order to constitute relationship of an AE, the parameters laid down in both subsections (1) and (2) of Section 92 should be fulfilled'.

The Tribunal observed that while interpreting a provision in a taxing statute, the construction should preserve the purpose of the provision. If more than one construction is possible, that which preserves its workability and efficacy is to be preferred to the one which would render it otiose or sterile. Thus, the Tribunal held that even if the taxpayer and JII may be related as per Section 92A(2)(g) but till the time their relationship will not satisfy the conditions laid down in 92A(1) they cannot be construed as AEs and therefore the provisions of chapter X of the Act have no application.

Page Industries Ltd. vs DCIT [IT(TP)A No. 163/Bang/2015] - AY 2010-11

For further details please refer to our Flash News dated 05 July 2016 available at this link

Arm's length principle cannot be invoked where replacement of self-declared prices of international transactions by ALP results in lowering of taxpayer's income chargeable to tax

The taxpayer followed a TP policy of marking-up its operating expenses by a margin of 20 per cent for purposes of invoicing its overseas AEs. During the course of assessment proceedings, the taxpayer broadly faced two challenges.

- an arm's length cost plus margin of 29.53 per cent was determined by the TPO as against the margin of the taxpayer of 20 per cent.
- the cost of Intra-Group Services (IGS) (say 10) received by the taxpayer from its AEs was held to be 'nil' (taxable income = 29.53 + disallowance on account of IGS 10 = 39.53).

Before the DRP, the first adjustment was deleted and mark-up rate of 20 per cent was restored since it was found to be at ALP. However, DRP declined to reverse the second adjustment on account of IGS (taxable income = 20 + Disallowance on account of IGS, 10 = 30).

Tribunal's ruling

Tribunal addressed the limited issue of whether the approach adopted by Revenue was sustainable in the eyes of law in view of embargo placed by Section 92(3) of the Act. The Tribunal expressed the view that since the mark-up rate of 20 per cent was held to be at arm's length, disallowance of

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costs on account of IGS (i.e. 10) would result in diminution of operating expenses by the same amount, which would trigger a correlative downward adjustment in gross revenues by a factor greater than such disallowance by 20 per cent (viz. 10 + 20 per cent of 10 = 12). Effectively, in Tribunal's view, for each 1 unit of disallowance in costs, the gross revenue of the taxpayer would need to be correspondingly adjusted downwards by an amount of 1.20, thereby resulting in pro-rata net reduction in taxable income of the taxpayer in comparison to what had been reported in its income tax return.

Section 92(3) of the Act provides that computation(s) with reference to arm's length principle cannot be carried out in a manner which is derogatory to entries recorded by the taxpayer in its books of account whereby it results in reduction of self-declared income chargeable to tax. Accordingly, the adjustment on account of IGS was deleted and taxpayer's returned position was restored.

Mercer Consulting India Pvt Ltd vs DCIT (ITA No. 1085/Del/2016)

For further details please refer to our Flash News dated 02 September 2016 available at this link

Corporate guarantee adjudged as shareholder service under exceptional circumstances and Interest on outbound loans to be determined applying sophisticated manner of loan benchmarking

The taxpayer had set up a special purpose vehicle (SPV) in the Bahamas, Tega Investment Ltd. (Tega Bahamas) for undertaking acquisition of two operating companies based in South Africa.

The taxpayer also provided a shareholder loan to Tega Bahamas and a corporate guarantee to ICICI Bank, U.K., in order to make adequate funds available to Tega Bahamas for acquiring the South African entities. These funding were provided by the taxpayer as a substitute to equity funding to Tega Bahamas for furthering its own intent of acquiring the two South African entities. Accordingly, the taxpayer classified the loan as performing a shareholder function, thus warranting no charge, and guarantee as shareholder service meriting no consideration.

The taxpayer placed reliance on guidelines of Australian Tax Office (92/11), OECD and U.K. Inland Revenue to hold that in the instant case, no third party financier would have lent money to the SPV without the guarantee having been extended by the parent company, having regard to its skewed debt equity ratio; and that no benefit actually accrued to the SPV, for which it would be willing to pay any guarantee commission.

The TPO and DRP disregarded the taxpayer's contention (both in connection with the provision of loans and guarantees) and computed an additional charge on both.

In addition to the guarantee, the taxpayer had provided working capital loans to its AEs (operational and not SPVs) in Australia on which it charged an arm's length interest on the basis of sophisticated manner of loan benchmarking, with reference to credit ratings and comparability of third party loan agreements.

The TPO disregarded the taxpayer's approach by determining credit rating on the basis of bias selection of financial ratios and subjectively downgrading the rating determined through quantitative parameters.

Tribunal's ruling

In relation to loan and corporate guarantee provided to its SPV, the Tribunal appreciated that the taxpayer's expectation from provision of loan and guarantee are not that of a lender or guarantor i.e. to earn a market rate of interest or guarantee fee, rather, the expectation was of a shareholder to protect its investment interest and help it to achieve acquisition of the South African entities for furtherance of its own business interest and get a return in terms of appreciation in value and dividends. The Tribunal was considerate to the evidence brought on records that no third party would have agreed to grant loans on an independent basis to Tega Bahamas given its skewed debt-equity ratio reflected in the balance sheet with low equity funding. Therefore, the loan was considered to be as quasi-equity and guarantee as a shareholder service meriting no charge.

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The Tribunal also addressed the issue on working capital loans advanced by the taxpayer to its AEs (operational and not SPVs) by setting aside the matter to the file of the TPO for re-adjudication as per sophisticated manner of loan benchmarking, with reference to the credit ratings and comparability of third party loan agreements, already provided by the taxpayer.

Tega Industries Ltd. vs DCIT (ITA No. 1912/Kol/2012)

For further details please refer to our Flash News dated 13 October 2016 available at this link

India - USA competent authorities resolve more than 100 cases under MAP and agree on terms and conditions of first Indo-US Bilateral APA

A CBDT press release dated 17 November 2016 stated that more than 100 cases under the MAP between India and the USA have been agreed to be resolved. Further, terms and conditions of the first ever Bilateral APA involving India and USA have also been agreed upon. This development is a result of the Framework Agreement signed by India and USA in January 2015, which sought to resolve about 200 past TP disputes between India and USA in the Information Technology (IT) Services and Information Technology enabled Services (ITeS) segments.

Key highlights of the press release

- Bilateral Competent Authority meeting between India and USA was held in Washington DC, USA during the last week of October 2016 during which 66 MAP cases relating to TP issues and 42 MAP cases relating to treaty interpretation issues were agreed to be resolved successfully.
- The total amount locked up in dispute in these cases is approximately INR5,000 crore and these cases relate to AYs ranging from AY 1999-2000 to AY 2011-12.
- The resolved cases pertain to various TP and international tax issues like:
  - Adjustments made to the international transactions in the nature of payment of royalty, management fees, cost contribution arrangements, engineering design services, contract R&D services, investment advisory services, marketing support services, software development services, ITES (both BPO and KPO services), etc. and
  - Treaty interpretation issues in the nature of presence of PE in India and profit attribution to such PEs, disputes pertaining to royalty income v/s business income of foreign companies, etc.
- An agreement has been reached on the terms and conditions of the first ever Bilateral APA involving India and USA within a short span of eight months, after USA started its bilateral process with India in February 2016 by starting to accept applications from US taxpayers.

CBDT press release dated 17 November 2016

For further details please refer to our Flash News dated 18 November 2016 available at this link

Individual taxation

Chennai Tribunal rules that the residential status is relevant while exercising option and not during the vesting period for taxability of SARs

The Chennai Tribunal, in the case of Shri Soundarrajan Parthasarathy and Shri Kummathi Rameswar Reddy held that the value of Stock Appreciation Rights (SARs) received by the assessees (employees of an Indian company having a U.S. parent) is taxable either as benefit in lieu of salary or as a perquisite under Section 17 of the Act.

The Tribunal rejected the assessees claim that SARs was a capital asset and cannot be treated as income. It held that the incentive is given to the assessees as a compensation for the services rendered. It was not given for transfer of capital asset or termination of any source of income.

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Therefore, the right conferred on the assesse under the scheme cannot be construed as capital asset. Further, this payment is in addition to salary for the service rendered. Therefore, the Tribunal held that the SARs benefit received by the assessees is a perquisite in the hands of the assessees or benefit in lieu of salary for the services rendered.

The Tribunal also held that merely because the assessees were non-residents and rendered service outside India during the vesting period that cannot be a reason for claiming that the same was not taxable in India. When the assessees exercised option for SARs, they were residents in India. Therefore, when the SARs was vested irrespective of the residency, the same is liable for taxation in India.

In relation to the double taxation of SAR benefit in India and the USA, ITAT remarked that there was no material evidence to support the claim that the value of SARs suffered tax in the USA. However, taking note of assessees' submission that the value of SARs was subjected to taxation in USA, ITAT held that the same needed to be examined in the light of tax treaty between India and the USA. The Tribunal thus, remitted back the matter to the file of AO for limited purpose of examining whether assessees have paid tax in USA on the same SAR benefit in the light of India-USA tax treaty.

Shri Soundarrajan Parthasarathy and Shri Kummathi Rameswar Reddy v. DCIT [2016] 159 ITD 21(Chen)

For further details please refer to our Flash News dated 12 May 2016 available at this link

TDS at 20 per cent does not apply automatically under Section 206AA where PAN is invalid or not furnished

- Section 206AA of the Act makes it obligatory for the employers to deduct tax at the higher of:
  - at the rate specified in the relevant provision of this Act; or
  - at the rate or rates in force; or
  - at the rate of twenty per cent.
- In case of deduction of tax on salary paid to the employees, the employer needs to comply with the provisions of Section 206AA, failing which interest may be levied on the short deduction of tax as per Section 201(1A) of the Act.
- The Vishakhapatnam Tribunal held[1] that it is not necessary that all payments are comes under 20 per cent flat rate, in some cases the rate of tax may be at 10 per cent and in some cases it may be at 30 per cent.

Tribunal's Ruling:

- The Tribunal observed that the Section 206AA provides for deduction of tax at higher rates, in case the deductee fails to furnish the correct PAN to the person responsible for deducting tax at source. In the event, the deductee fails to furnish PAN, then the deductor shall deduct tax at the rates which is higher of (i) at the rates specified in the relevant provisions of the Act, or (ii) at the rate or rates in force, or (iii) at the rate of twenty percent.
- The Tribunal clarified that it was not automatic that a flat rate of 20 per cent shall be deducted wherever PAN is not furnished and that the deductor shall compute the tax in the manner specified under section 206AA of the Act, by applying the rate specified under the relevant provision of this act, or at the rate or rates in force and then, compared to flat rate of 20 per cent to decide whichever is higher.
- The arguments of the assessee were accepted by the Tribunal as the payment covered under dispute was salary to employees.
- The Tribunal spelt out clearly that the TDS on salary shall be deducted in the manner specified under Section 192 of the Act, after allowing basic exemption limit and deductions towards investments in savings scheme etc. Unlike other provisions, TDS on salary cannot be deducted

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by applying flat rate of tax on gross payment.

- The Tribunal held that as Section 206AA provides for tax deduction at the higher of the three rates prescribed, it was not necessary that all payments are comes under 20 per cent flat rate, in some cases the rate of tax may be at 10 per cent and in some cases it may be at 30 per cent and that the onus was on the Revenue to demonstrate that the correct tax had not been recovered from the person who had the primary liability to pay tax.
- The Tribunal opined that the AO/ TDS officer was not correct in computing the short deduction of tax and interest, by applying flat rate of 20 per cent. The CIT(A), without appreciating the facts, simply upheld the action of AO/TDS officer.
- The issue was remanded to the AO/ TDS officer in order to examine the issue in the light of the discussions above and to provide an opportunity of hearing to the assessee.

Rashtriya Ispat Nigam Ltd. v. ACIT [2016] 157 ITD 366 (Viz)

For further details please refer to our Flash News dated 4 February 2016 available at this link

Pegging perquisite valuation to SBI-rate for bank employees' concessional loans, no 'hardship'

The Act seeks to tax[8] perquisites/benefits provided by employers as income from salaries and has also prescribed[9] the valuation rules. One such specified perquisite is grant of loans at a concessional rate of interest. The value of this perquisite is computed as the difference between the rate of interest charged by State Bank of India (SBI) on a specified date for the same purpose and the rate of interest at which the loan was granted by the employer (if lower than the SBI rate). The Madras High Court held[10] that this valuation methodology does not create any 'hardship' and that the perquisite in the form of concessional rate of interest is subject to tax as prescribed.

- Employees of banks other than SBI were granted loans by their employers at a concessional rate of interest which was less than the rate charged by SBI for the same purpose.
- The petitioner (All India Union Bank Officers Federation) challenged the constitutional validity of Section 17(2)(viii) of the Act and rule 3(7)(i) of the Rules on the following grounds:
  - By using SBI rate as the basis for determining whether the grant of interest-fee or concessional loan to an employee is a perquisite or not, the Rule Making Authority has deprived the individual employees of their right to contest the jurisdictional fact of such loan not being a concession/benefit and that rule 3(7)(i) of the Rules is *ultra vires* section 17(2)(viii) of the Act;
  - Each bank fixes[11] its own rate of interest depending on its economies of operation. Without realising this, rule 3(7)(i) of the Rules seeks to treat unequals as equals by pegging rate of interest charged by the individual banks to their employees with the SBI rate of interest. Hence, rule 3(7)(i) violates Article 14 of the Constitution;
  - Rule 3(7)(i) of the Rules works out a hardship to the employees. Hardship is a ground on which a subordinate legislation can be tested; and
  - Rule 3(7)(i) is vitiated in as much as it tends to overrule an earlier judgment of the Supreme Court in the case of Arunkumar[12].

High Court's ruling:

- The High Court observed that the Arunkumar judgement was not applicable in the instant case since there was a need for adjudication as to what was a 'concession' in the matter of rent. In the

[8] Section 17(2)(vi) of Act as amended by the Finance Act, 2004 which became Section 17(2)(viii) effective 1 April 2010
[9] Rule 3(7)(i) of the Income-tax Rules, 1962 as amended by Income Tax (First Amendment) Rules, 2004
[10] All India Union Bank Officers Federation v. UOI [2016] 69 taxmann.com 371 (Madras)
[11] Notification dated 9 April 2010 and Master Circular dated 31 July 2015
[12] Arunkumar vs Union of India [2007 (1) SCC 732]

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instant case, the word ‘concession’ was not used in Section 17(2)(viii) of the Act and the only *sine qua non* for invocation of the section was the existence of a fringe benefit or amenity.

- In light of the above, rule 3(7)(i) of the Rules is not *ultra vires* section 17(2)(viii) of the Act.
- Rule 3(7)(i) of the Rules does not seek to include an interest free or concessional loan taken by one set of employees to the exclusion of others. The rule does not also stipulate different methods of valuation of the perquisite. It does not seek to apply a uniform rate for different categories of persons irrespective of the huge difference in their pay pockets. Hence, there is no violation of Article 14 of the Constitution.
- Rule 3(7)(i) of the Rules decreases the value of the privilege given to an employee by an employer, perhaps to the maximum extent of about 30 per cent[13]. This can never be considered as a hardship.
- The Supreme Court in the case of Herbertsons Ltd[14] observed that where the quantum of salary fixed and the amenities granted to the employees under a settlement, have to be looked at as a package. This rationale was in favour of the Revenue - if salary is taxable and some perquisite or benefit forms part of a package, the same should also be taxed. Therefore, the challenge to Section 17(2)(viii) of the Act as well as rule 3(7)(i) of the Rules has to fail.

All India Union Bank Officers Federation v. UOI [2016] 385 ITR 114 (Mad)

For further details please refer to our Flash News dated 1 June 2016 available at this link

Salary received by a non-resident in India for services rendered outside India not eligible for exemption under the tax treaty

Tax treaties provide relief from taxation in case the same income is taxable in more than one jurisdiction. Typically, under most treaties, two kinds of benefits are provided in respect of salary income - exclusion benefit [where salary earned by a resident of a country is taxable only in the country of his/ her tax residency, unless services are rendered in the other country, in which case salary for such services may be taxable in both countries] and FTC [credit of taxes paid overseas from the tax liability in the home country in order to eliminate double taxation]. The Act permits that the beneficial provisions under the treaties would apply in order to avoid double taxation. The Chennai Tribunal in the case of Swaminathan Ravichandran[15] held that a non-resident is not eligible to claim any benefit under the treaty.

- Swaminathan Ravichandran (the assessee) had received salary in India for the services rendered in China. As the salary was paid in India for the entire FY, the Indian employer had deducted tax at source on such salary payment.
- During the relevant FY, the assessee qualified as a tax resident of China and a non-resident of India for the FY 2010-11.
- As per Article 15(1) of the treaty between India and China, a resident of China receiving salary for services rendered in China was taxable only in China. Accordingly, in his India Tax Return (ITR), the assessee had claimed benefit under Article 15(1) of the treaty and claimed a refund[16] of TDS by the Indian employer on such salary.
- As the Article 23 of the treaty between India and China applies only to residents of India, the assessee, by virtue of being a non-resident in India, was not eligible to claim exemption under Article 15(1) of the treaty.

[13] Maximum rate of tax, excluding surcharge and cess
[14] Herbertsons Ltd. v. Workmen [1976 (4) SCC 736]
[15] Swaminathan Ravichandran v. ITO (ITA No. 299/Mds/2016)
[16] On applying beneficial provisions under Section 90 of the Act

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- The Chennai Tribunal upheld the order of the CIT(A) and denied exemption under Article 15(1) of the treaty to the taxpayer.

Swaminathan Ravichandran v. ITO (ITA No. 299/Mds/2016)

For more details, please refer to our Flash News dated 26 August 2016 available at this link

Workplace dress code prescribed by employer does not qualify as a uniform; such allowance is not eligible for tax exemption

The allowance paid by an employer to its employees for the purchase or maintenance of a uniform is eligible for tax exemption[17] in the hands of the employees under the Act. Recently, the Gujarat High Court held[18] that the dress code prescribed by an employer to be worn at the workplace cannot be equated to a uniform. Accordingly, the uniform allowance paid for the purchase/ maintenance of a dress code is not eligible for exemption from tax as a 'uniform allowance' and is hence liable for TDS by the employer.

- Oil and Natural Gas Corporation (the assessee) was required by the AO to provide its employees' salary payment details and TDS on the same for the Assessment Year (AY) 2010-11.
- During the course of the assessment, an officer of the assessee submitted the following before the AO:
  - The assessee had earlier prescribed a uniform to its employees.
  - This uniform was done away with effective 16 November 1995.
  - However, based on an understanding with the unions, though the uniform was discontinued the assessee agreed to provide the benefit of the uniform allowance to its employees in the form of: a uniform allowance (70 per cent), canteen subsidy (20 per cent) and washing allowance (10 per cent).
  - The amount of these allowances was adjusted by the assessee towards the additional contribution by employees to post-retirement benefit schemes.
- The AO passed an assessment order disallowing the expenditure incurred by the assessee in respect of the uniform allowance paid to its employees on the following basis:
  - During the survey conducted by the AO in the premises of the assessee during the Financial Year (FY) 2009-09, the employees of the assessee were not found to be wearing a uniform.
  - A precise dress code with colour patterns needs to be prescribed in order to qualify as a 'uniform'.
  - The assessee had discontinued the uniform prescribed to its employees effective 1995. Hence, the uniform allowance paid to employees was liable for TDS by the assessee. Accordingly, expenditure incurred by the assessee in respect of such a uniform allowance was disallowed.
- The High Court could not accept such alternative submission on the following grounds:
  - There was nothing on record to suggest that there was any dress code prescribed prior to the circular dated 29 March 2010. Hence, in the absence of any evidence, it was not possible to ascertain the nature of the dress code.
  - Assuming that a dress code as in the circular dated 29 March 2010 or similar was prescribed for the AY 2010-11, such would not qualify as a 'uniform'.

[17] Section 10(14)(i) of the Act read with Rule 2BB(1)(f) of the Income-tax Rules, 1962
[18] Oil and Natural Gas Corporation Limited v. CIT (TDS) (Tax Appeal 368 and 371of 2016)

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- The specifications in the said circular fit the common parlance of the term 'dress code' which is the minimum standard of dressing depending on the place or occasion. Such specifications would cover a wide range of choice of clothes, rather than specify a precise set of clothes.
- The term 'uniform' in the context of dressing would necessarily include precise instructions as to the dress, design and colours so as to achieve uniformity in dress at a work place or place of study.
- 'Uniform' in the context of dressing has been defined in the dictionary[19] as a dress of a distinctive design prescribed for members of a particular group (as an armed service, an order, or a social or a work group) and serving as a means of identification. The term 'uniform' carries a precise meaning which is entirely different from the broader concept of a dress code.

- On the basis of the materials produced on record, the High Court dismissed the appeal of the assessee and upheld the order of the AO.

Oil and Natural Gas Corporation Limited v. CIT (Tax Appeal 368 and 371of 2016) (Guj)

For more details, please refer to our Flash News dated 28 September 2016 available at this link

Employees' Provident Fund Organisation issues consolidated guidelines to secure proper compliance for overseas assignments

India has signed several Social Security Agreements (SSAs) with other countries with a view to obtaining an exemption from contribution towards social security in the host countries for outbound employees, provided that they contribute to social security in India. To obtain this exemption, an outbound employee requires a Certificate of Coverage (COC) from the designated agency, the Employees' Provident Fund Organisation (EPFO), which serves as a proof of social security contribution in India.

Recently, the EPFO has issued a circular for securing proper compliances in respect of employees going for overseas assignments. In the circular, the PF department has stated that since the different regional Provident Fund (PF) offices were adopting different practices with regard to compliance for Indian employees going to work in foreign countries, there was a need to lay down consolidated guidelines for proper compliances.

Key clarifications provided in the circular:

Fundamental principle of deducting and paying PF and other dues in India for employers sending employees on an overseas assignment

- PF contributions and other dues should be deducted and deposited by the Indian employer only when the salary/ wages are paid or payable by the Indian employer.

Proper compliance requirement in case of employees moving to an overseas country

- Compliance requirement in case of employees going to a country with which India has an effective SSA:
  - The EPFO has clarified that in order to obtain the COC, PF compliances should continue during the period of assignment and it should remain same as it was being reported immediately before the start of the overseas assignment.
  - However, if the employee does not obtain the COC, PF compliances would be made on such salary which is being paid or payable by the Indian employer.
- Compliance requirements in case of employees going to a country with which India does not have an effective SSA:
  - The PF compliance should be made on such salary which is being paid or is payable by the employer in India.

[19] Webster's Third New International Dictionary (Unabridged)

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This is an important circular which may have significant implication for companies with sizable outbound employee population (such as software firms, BPOs, KPOs and other IT/ITES companies etc.).

The clarification provided by the PF authorities, that PF liability will not arise in case of overseas assignments where the salary is neither paid nor payable by the Indian employer, is a welcome development for the Indian industry. This circular is expected to reduce overseas assignment costs and should also help employers facing litigation from PF authorities with respect to overseas assignments.

Employers who have obtained COCs in the past should review their compliances under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (EPF Act), to check whether the compliances are in line with the clarification made in this circular. This circular should also be kept in view by the employers for future overseas assignment planning.

Employers are complying under the EPF Act on a notional salary or shadow payroll, may need to revisit their policies from the PF, tax and other regulatory perspectives.

Source: www.epfindia.com

For more details, please refer to our Flash News dated 28 January 2016 available at this link

The Government of India issues a notification on coverage of Banks under EPF Act

The Ministry of Labour and Employment, Government of India has issued a notification with regard to the applicability of EPF Act on banks.

The government notified that the EPF Act shall apply to all banks, employing twenty or more number of persons as a class of establishment, for those employees who are not entitled to the benefit of contributory provident fund or old age pension under any scheme or rules framed by:

- central government or
- state government or
- respective banks established under the Banking Regulations Act, 1949.

This is an important change for banks which were previously not covered under the EPF Act. The government's intent seems to widen the social security coverage in India. In view of this notification, those banks, which are not currently covered under the EPF Act, should review their schemes or rules regarding contributory provident fund and old age pension benefits to their employees to ascertain the applicability of the EPF Act.

Notification No. S.O. 440(E) dated 10 February 2016 [F. No. S-35018/10/2013-SS.II]

For more details, please refer to our Flash News dated 3 March 2016 available at this link

India's Social Security Agreement with Australia comes into effect

EPFO has issued a circular notifying that the SSA between India and Australia has come into effect from 1 January 2016.

This SSA aims at achieving equality on the principle of reciprocity to benefit employees who are posted in another country, by their employers. The India-Australia SSA is the sixteenth SSA to come into effect.

The countries with which India has effective SSAs are Belgium, Germany, Switzerland, Denmark, Luxembourg, France, Republic of Korea, Netherlands, Hungary, Finland, Sweden, Czech Republic, Norway, Austria, Canada and Australia.

Potential benefits under the India-Australia SSA

- Exemption from social security contribution in the host country

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- Totalisation of contributory periods
- Export of benefits

Thus, implementation of the SSA between India and Australia is a welcome step as it can help save costs in international assignments between the two nations as well as take into account social protection of international assignees. This could lead to increased economic activity between the two countries.

Source: www.epfindia.com

For more details, please refer to our Flash News dated 18 March 2016 available at this link

The Government of India enhances benefits under the Employees' Deposit-Linked Insurance Scheme, 1976

The EPF Act is an employee welfare legislation aimed at, inter alia, securing welfare of the employees upon termination of their employment. The following schemes have been established under the EPF Act:

- The Employees' Provident Funds Scheme, 1952 (EPFS)
- The Employees' Pension Scheme, 1995 (EPS)
- The Employees' Deposit-Linked Insurance Scheme, 1976 (EDLIS).

The EDLIS facilitates the grant of assurance benefit in the event of death of an employee who was a member of the EDLIS. Under the EDLIS, the assurance benefits were limited to a maximum of three-lakh sixty thousand rupees (INR360,000).

Key amendment

The Ministry of Labour and Employment, Government of India issued a Notification no. G.S.R. 543(E), dated 24 May, 2016 to increase the quantum of benefits to a maximum ceiling of six lakh rupees (INR 600,000) by amending the provisions in the EDLIS.

EPFO has also issued a circular in this regard directing its officials to make necessary arrangements to grant the increased benefits. The assurance benefits will be calculated at thirty times the monthly wages (subject to the wage ceiling of INR15,000) plus 50 per cent of the average balance in the provident fund account of the deceased during the preceding twelve months or during the period of membership whichever is less (subject to a cap of INR150,000).

The overall cap on assurance benefit, therefore, will be INR 600,000 under the revised EDLIS provisions. In the circular, EPFO has also mentioned that all the establishments that have taken out insurance policies in lieu of EDLIS and are exempted from EDLIS should modify their present schemes accordingly and grant the enhanced benefits to the beneficiaries.

Source: www.epfindia.com

For more details, please refer to our Flash News dated 14 June 2016 available at this link

India's Social Security Agreement with Japan will come into effect from 1 October 2016

The Social Security Agreement between India and Japan was signed on 16 November 2012. The Ministry of External Affairs notified the SSA between India and Japan which has come into effect from 1 October 2016.

This SSA aims at achieving equality on the principle of reciprocity to benefit employees who are posted in another country, by their employers. The India-Japan SSA is the seventeenth SSA to come into effect.

The countries with which India has effective SSAs are Belgium, Germany, Switzerland, Denmark, Luxembourg, France, Republic of Korea, Netherlands, Hungary, Finland, Sweden, Czech

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Republic, Norway, Austria, Canada and Australia.

Key potential benefits under the India-Japan SSA

- Exemption from social security contribution in the host country
- Totalisation of contributory periods
- Lump-sum refunds
- Export of benefits

The notification of entry into force of the SSA between India and Japan is a welcome step as it can help save costs in international assignments between the two nations as well as take into account the social protection of international assignees. This could lead to increased economic activity between the two countries.

For more details, please refer to our flash news dated 21 July 2016 available at this link

Nepalese and Bhutanese national will be treated as Indian workers under the Employees' Provident Funds & Miscellaneous Provisions Act, 1952

In October 2008, GOI made fundamental changes in the EPFS and EPS by bringing International Workers (IWs) under the purview of the Indian social security regime.

The definition of IWs under EPFS includes two categories:

(a) an Indian employee having worked or going to work in a foreign country with which India has entered into a social security agreement and being eligible to avail the benefits under a social security programme of that country, by virtue of the eligibility gained or going to gain, under the said agreement;

(b) an employee other than an Indian employee, holding other than an Indian passport, working for an establishment in India to which the EPF Act applies.

The Ministry of Labour and Employment, Government of India issued a notification (Notification No. G.S.R. 1035 (E) and Notification No. G.S.R. 1036 (E), dated 2 November, 2016, published in the Gazette of India) providing that a Nepalese national and a Bhutanese national shall be deemed to be an Indian worker. This notification shall be effective from 2 November 2016.

Key amendments

A new proviso has been inserted in the definition of IWs under the EPFS and EPS and it states that:

"Provided that the worker who is a Nepalese national on account of Treaty of Peace and Friendship of 1950 and the worker who is a Bhutanese national on account of India-Bhutan Friendship Treaty of 2007, shall be deemed to be an Indian worker."

This is an important notification which may have significant benefit for companies employing Nepalese and Bhutanese nationals. The clause added by the Government of India is a welcome step for the Indian industry as it would reduce the PF liability for such employees and reduce the cost of compliances under the EPF Act. However, a clarification on the following aspects from the PF department would be helpful for the industry:

Whether Nepalese/Bhutanese nationals who have been working in India prior to 2 November 2016 will be treated as Indian workers in relation to contributions towards the EPFS and EPS and whether they will be eligible for withdrawal benefits as applicable to Indian workers.

G.O.I. Notification No. G.S.R. 1035 (E) and Notification No. G.S.R. 1036 (E), dated 2 November, 2016, published in the Gazette of India

For more details, please refer to our Flash News dated 7 November 2016 available at this link

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Indirect taxes

Service tax

Salary and allowances paid by Indian company to an expatriate not liable to Service tax under negative list regime

In the present case, the issue involved was whether salary and other allowances paid by an Indian company to an expatriate employee as per the terms of a tripartite agreement with the expatriate and the foreign group company would be liable to Service tax. Further, the social security obligation born by the foreign company are not reimbursed by the Indian company.

The AAR observed that so long as the expatriate was an employee of the Indian company, bearing of certain interests (such as social security) by the foreign company would not alter the nature of the transaction. Further, with the introduction of negative list regime of taxation of services, services provided by an employee to an employer in the course of or in relation to employment are not included in the definition of services.

Accordingly, the AAR held that payment of salary and other allowances by the Indian company would not be liable to Service tax since the employee was providing services to the employer (i.e. the Indian company) in his capacity as an employee.

M/s North American Coal Corporation India Pvt. Ltd. v. Commissioner of Central Excise, Pune – III (Advance Ruling) Ruling No. AAR/ST/13/2015 in Application No. AAR/44/ST/2/2014

Support services provided to foreign customer not liable to Service tax

In the present case, the issue was whether gamut of support services (viz. direct marketing, branding activities, offline marketing, supervision of quality of third party customer care center, etc.) proposed to be provided by GoDaddy India Web Services Pvt Ltd (the taxpayer) to its group company located outside India would be liable to Service tax.

The AAR held that the services provided by the taxpayer would constitute naturally bundled services which are not in the nature of ‘intermediary services’ on the basis of the following reasons:

- Services proposed to be provided by the taxpayer are not peculiar to taxpayer’s case but are provided by various Indian entities to their overseas customers as a single package;
- Payment for the entire package would be a lump sum amount;
- Supporting business of foreign group company in India is the main service and services like processing payments and oversight of services of third party call centers are ancillary and incidental to the provision of main service i.e., business support service; and
- The definition of ‘intermediary’ does not include a person who provides the main service on his own account. In the present case, the taxpayer proposed to provide the main service i.e. ‘business support service’ to its foreign group company on his own account on a principle to principle basis.

Based on the above, it would get covered under Rule 3 of the Place of Provision of Services Rules, 2012 and hence, would qualify as ‘export’.

GoDaddy India Web Services Pvt. Ltd. v. Commissioner of Service tax, Delhi –IV [AIT-2016-25-AAR]

Income tax deducted at source on consideration paid to foreign-service provider does not attract Service tax

In the instant case, the issue was whether TDS deposited to the Government on the consideration paid to a foreign-service provider (which was agreed to be net of TDS amount) would be liable to

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Service tax under reverse charge mechanism.

The Mumbai Tribunal held that on a plain reading of the Service tax law as applicable on the time being in force, it appears that Service tax liability should be discharged on amount billed by the service provider._Accordingly, since the amount billed by the foreign service provider in the present case was net of TDS and TDS amount was borne by the service recipient, such TDS amount would not be liable to Service tax under reverse charge mechanism.

M/s Magarpatta Township Development & Construction Co. Ltd. v. Commissioner of Central Excise, Pune – III [TS-90-CESTAT-2016(Mumbai)]

Provisional entry attracts point of taxation in case of associated enterprises

The issue in the instant case was whether the appellant providing services to its associate enterprise can be subject to interest on account of paying Service tax in the month of passing final entries in the books of accounts instead of the month of recording the provisional entries.

The Mumbai Tribunal held that such provisional entries are to be considered while determining the liability of Service tax and point of taxation is date of recording of such provisional entries, despite such entries being mere adjustment in the books of accounts.

Commissioner of Service tax, Mumbai – I v. M/s Deutsche Asset Management (I) Pvt. Ltd. [2016 – VIL – 203 – CESTAT – MUM – ST]

Principle of mutuality is applicable when overseas branch has no independent existence from head office

The issue in the instant case was whether payments made by head offices to branch offices located outside India for disbursement of salary and other expenses by the overseas branches (in relation to the personnel of head office deputed to the overseas customer sites) would be subject to Service tax under reverse charge mechanism on the premise that a branch beyond the jurisdiction of the statute is deemed to be a distinct establishment for the purpose of Service tax.

The CESTAT held that such payments will not attract Service tax basis the following observations:

- The activity of head office and branch office are inextricably related.
- There is no independent existence of the overseas branch as a business, and the economic survival of the branch is entirely dependent on the finances provided by the head office.
- The transfer of funds is nothing but the reimbursements and taxing of reimbursements would amount to taxing of transfer of funds which is not contemplated under Services tax laws.

Tech Mahindra Ltd. v. Commissioner of Central Excise [TS -140 -CESTAT-2016-ST]

Notification to allow rebate of Service tax in specified cases

Earlier vide Notification 41/2012 – ST rebate of Service tax paid on services used beyond the factory gate only was allowed. Now, the Government has issued Notification to amend the said Notification allowing rebate of Service tax paid on services used beyond the factory or any other place or premises of production or manufacture of excisable goods for export of the said goods. The new Notification also, amended the percentage rate available for refund subject to prescribed conditions.

Notification No.1/2016-Service tax dated 3 February 2016

Notifications to allow refund/ rebate of Swachh Bharat Cess in specified cases

The Government has issued two notifications to allow refund/ rebate of Swachh Bharat Cess in the following specified cases subject to prescribed conditions:

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- Refund of Swachh Bharat Cess paid by Special Economic Zone (SEZ) units or developers on specified services wherein ab-initio exemption from Service tax is available but not claimed; and
- Rebate of Swachh Bharat Cess paid on all services, used in providing 'export' of services in terms of Rule 6A of the Service Tax Rules, 1994.

Notification No.2/2016-Service tax dated 3 February 2016 and Notification No.3/2016-Service tax dated 3 February 2016

Service tax leviable on all services provided by Government/ local authority to a business entity with effect from 1 April 2016

With effect from 1 April 2016, any services provided by Government/local authority to a business entity have been excluded from the negative list of services and hence, are liable to Service tax. Further, specific exemption has been granted to services provided by Government/local authority to a business entity with a turnover below INR 10 lakhs.

Notification No.6/2016-Service tax and Notification No.7/2016-Service tax dated 18 February 2016

Point of taxation in case of change in liability under reverse charge would be issuance of invoice

In the event of change in liability or change in extent of liability of a person paying tax under reverse charge mechanism, point of taxation would be the date of issuance of invoice where service has been provided and invoice has been issued but payment has not been received before such change.

Notification No.21/2016-Service tax dated 30 March 2016

Point of taxation in cases of services provided by Government would be earlier of date of issuance of invoice or payment

Government has notified that point of taxation of services provided by Government or local authority to any business entity shall be earlier date from payment date or date on which payment (part or full) becomes due as specified in invoice/ bill/challan/any other document issued by the Government or local authority demanding such payment.

Notification No.24/2016-Service tax, dated 13 April 2016

Withdrawal of service tax exemption on specified services provided by Government / local authority to business entities

With effect from 20 May 2016, the exemption on certain specified services provided by Government/ local authority to business entities (with turnover less than INR 10 lakhs in preceding financial year) such as services provided by Department of Posts by way of speed post, services in relation to aircraft/ vessel, services by way of renting of immoveable property, life insurance services etc., has been withdrawn.

Notification No. 26/2016-ST, dated 20 May 2016

Clarification on Service tax on freight forwarders on transportation of goods

On the issue of applicability of Service tax on services of freight forwarders on transportation of goods from India, the CBEC has *inter alia* clarified that where the freight forwarder is merely an agent who charges the rate prescribed by the airline/carrier/ ocean liner (located outside India), the services would qualify as 'intermediary' services and be liable to Service tax. On the other hand,

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where the freight forwarder undertakes the responsibility for actual transportation with discretion to negotiate rates, the services would qualify as 'transportation of goods by air/sea' and would not be liable to Service tax.

Circular No. 197/7/2016 – ST, dated 12 August 2016

Amendment in taxability of Online Information and Database Retrieval Services (OIDAR services)

The Central Government has issued various notifications to amend certain key provisions pertaining to OIDAR services provided by persons located outside India. Accordingly, with effect from 1 December 2016, OIDAR services provided to non-assessee online recipient i.e. Government/ local authority/ Governmental authority or an individual in relation to any purpose other than commerce, industry or any other business or profession, located in taxable territory, then, in such scenario, the service provider located outside India providing such services would be required to obtain registration under Service tax laws, discharge Service tax liability and undertake periodic compliances in India. In other cases (such as where such services are provided to companies), the liability to discharge Service tax would devolve on the service recipient under reverse charge mechanism.

Notification No.46/2016-Service tax dated 9 November 2016, Notification No.47 /2016-Service tax dated 9 November 2016 , Notification No.48/2016-Service tax dated 9 November 2016, Notification No.49 /2016-Service tax dated 9 November 2016 and Circular No. 202/12/2016 – Service tax dated 9 November 2016

Excise Duty

Amendment in CENVAT Credit Rules, 2004

Rule 6(3)(i) of CENVAT Credit Rules, 2004 has been amended to provide that the manufacturer of goods or the provider of output service, not maintaining separate accounts and *opting to pay six per cent of value of the exempted goods and seven per cent of value of the exempted services, shall pay such amount subject to a maximum of the total of opening balance of the credit of input and input services available at the beginning of the period to which the payment relates and the credit of input and input services taken during that period.*

Further, Rule 7B of CENVAT Credit Rules, 2004 has been amended to provide that the manufacturer having one or more factories, can take credit on inputs received under the cover of an invoice issued by a warehouse of the said manufacturer, who receives inputs under cover of documents specified under Rule 9. Of CENVAT Credit Rules,2004

Notification 23/2016- CX (N.T), dated 1 April 2016

Whether Interest is leviable on the differential duty amount paid under supplementary invoices due to price increase

In the instant case, the question before the Apex Court was *"Whether interest is leviable under Sec 11AB of the Central Excise Act, 1944 ('Section 11AB) on the differential duty amount paid under supplementary invoices due to price increase by virtue of price variation clause in the sale contract".*

The taxpayer cleared the manufactured goods on payment of Excise Duty. In terms of the price variation clause, the taxpayer had discharged differential duty and also intimated the same to the Revenue Authorities.

With the above background, a show cause notice was issued demanding interest under Sec 11AB. The Commissioner, Central Excise and CESTAT had also confirmed the demand for interest. Aggrieved by the same, the taxpayer preferred an appeal before Supreme Court.

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The Supreme Court observed that the interest under Sec 11AB can be levied/charged, where any duty of excise has not been levied or paid or has been short levied or short paid. In such an event, interest is liable to be paid from the first date of the month succeeding the month in which, the duty ought to have been paid. Further, the right of the seller to receive the revised price crystallizes only, when the buyer agrees to sanction the same, and only at that time, liability to pay duty, if at all, on the revised price arises. Both parties are not aware of the final price at the time, when the goods are removed.

The Supreme Court further observed that one has also to bear in mind the difference between 'what should be the quantum of duty to be paid' and 'when such duty is payable'. In the cases of price revision, the quantum of duty would be on the escalated price but the time for payment of differential duty is when the parties agree for the escalation in prices. On that reckoning, it would follow that interest clock for differential duty will start ticking from the date, differential duty is due.

To conclude, the Supreme Court observed that the decision in *SKF* and *Auto International* require a re-look and the Registry is directed to place the matter before the Chief Justice of India for constituting a Larger Bench.

Steel Authority of India Limited v. Commissioner of Central Excise (2015-TIOL-292-SC-CX)

Whether the 'Pre-delivery Inspection Charges (PDI) and 'After Sales Service Charges' (ASS) are to be included in the assessable value

In the present case, the question of law before the Apex Court for consideration was whether the 'Pre-Delivery Inspection Charges' and 'After Sales Service Charges' are to be included in the assessable value.

The taxpayer is engaged in the manufacture of two wheeled motor vehicles classifiable under HS Code 8711.20 and 8711.10. The taxpayer sold the goods directly to the customers through sales depots and had requested for the provisional assessment with respect to the depot sales as they could not determine the normal transaction value. The provisional assessment was finalized and the said order included PDI charges and free ASS charges in the assessable value. The reason for doing so by the Adjudicating Authority was the clarifications issued vide Circular No. 643/34/2002 dated 1 July 2002, wherein it has clarified the same to be included in the assessable value.

Aggrieved by the same, the taxpayer filed an appeal before the Commissioner (A), who disallowed inclusion of PDI charges and free ASS charges relying on the CESTAT decision in the case of *Maruti Udyog Limited*. Aggrieved by the said order, the Department filed an appeal before the Bangalore Tribunal and the Tribunal also, rejected the Department's appeal considering the decision in the case of Maruti Udyog Limited.

The matter was taken up by the Supreme Court and the Hon'ble Supreme Court considering the arguments observed that PDI charges and free ASS charges would not be included in the assessable value under Sec 4 of the Act for the purpose of paying excise duty.

CCE v. TVS Motors Company Limited (2015-TIOL-299-SC-CX)

Refund of CENVAT credit cannot be denied on the ground that it is filed for a year and not on quarterly basis

The issue is whether the taxpayer is eligible for the refund of the CENVAT credit that remained unutilized due to clearances under International Competitive Bidding. Further, adjudicating authority had rejected the said refund claim on the ground that the taxpayer has filed a single claim for the period January 2014 to December 2014, while Notification No 27/2012 stipulates for filing of quarterly refund claims. The authorities, also rejected the refund claim on the ground that shipping bill, which is a document indicated as per rule for evidencing export, duly certified was also not produced.

Aggrieved by such an order, the taxpayer filed an appeal before the first appellate authority. The

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first appellate authority allowed the appeal in favour of the taxpayer. Revenue being aggrieved by the order, filed an appeal.

The Mumbai Tribunal held that:

- The show cause notice did not require the respondent assessee to show cause for rejection of the claim on the ground that clearances made to International competitive bidding cannot be considered as exports. In the absence of such allegation, revenue cannot take this as a ground for setting aside the impugned order.

- Notification No- 27/2012 contemplates for filing of refund claims of un-utilized CENVAT credit quarterly, but it does not bar an assessee from filing refund claim for the entire period, which may be more than a quarter. In the absence of any explicit bar, refund claims, if otherwise eligible, cannot be rejected on the ground that they are not filed quarterly.

Hence, the appeal was rejected and refund allowed to the taxpayer.

CCE. v. Fabrimax Engineering Pvt Ltd [2016-TIOL-1926-CESTAT-MUM]

VAT

Sodexo Meal Vouchers are not 'goods' and not liable to Octroi or Local Body Tax

In the present case, the taxpayer provides pre-printed meal vouchers viz. 'Sodexo Meal Vouchers'. The taxpayer enters into contracts with its customers i.e. establishments/companies having number of employees on their rolls, for issuing the said vouchers. These customers provide food/ meals and other items to their employees. Further, for utilisation of these vouchers by such employees, the taxpayer has made arrangements with various restaurants, departmental stores, shops, etc. ('affiliates'). The employees can procure food and other items on presentation of the said vouchers and the affiliates, after receiving the said vouchers, present the same to the taxpayer and get reimbursement of the face value of those vouchers after deduction of service charge payable by the affiliates to the taxpayer as per their mutual arrangement.

In view of the above, the question before the Supreme Court was whether, based on the aforementioned arrangement, these vouchers can be treated as 'goods' for the purpose of levy of Octroi or Local Body Tax (LBT) as per the relevant provisions of the Maharashtra Municipal Corporation Act [Act No. LIX of 1949] or the said activity only amounts to rendering of service by the taxpayer.

SC observed that vouchers are not 'sold' by the taxpayer to its customers, as wrongly perceived by the Bombay High Court, and this fundamental mistake in understanding the whole scheme of arrangement has led to wrong conclusion by the High Court. The High Court has also wrongly observed that vouchers are capable of being sold after they are brought into the limits of the city. These vouchers are printed for a particular customer, which are used by the said customer for distribution to its employees and these vouchers are not transferrable at all.

Further, without the sanction/ authorization of the RBI to operate such a payment system under the Payment and Settlement Systems Act, 2007, nobody can operate such a system, as the purpose of the said Act is to regulate the payment and settlement thereof by means of ' Paper Based Vouchers '. The Supreme Court also observed that an insight into the Policy Guidelines issued by the RBI to regulate such transactions would also highlight that the real nature of the transaction is to provide service and by no stretch of imagination these vouchers can be termed as 'goods'.

The Supreme Court also noted that the real character of the transaction is the facility provided by the customers as employers to their employees. The value of such free food and non-alcoholic beverage provided by an employer to an employee is treated as expenditure incurred by the employer and amenity in the hands of the employee. It is this perquisite given by the customer to its employees by adopting the methodology of vouchers and for its proper implementation, services of the taxpayer are utilised.

In view of the above, the Supreme Court held that Sodexo Meal Vouchers are not 'goods' and

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therefore not liable for either Octroi or LBT.

Sodexo SVC India Private Limited v. State of Maharashtra and ORS (2015-TIOL-293-SC-MISC)

Licensing of technology through donor seeds for production of BT cotton hybrid seeds is deemed sale subject to VAT

In the present case, Mahyco Monsanto Biotech (India) Private Limited ('MMB' or the petitioner') has filed a writ petition with Bombay High Court on the issue of levy of VAT on transaction of transfer of 'BG technology' which kills specific insects effecting cotton crop.

The petitioner submitted that the transaction of granting the technology falls within the ambit of grant of permissive use rather than a transfer of a right to use. It is, therefore, a service and not a deemed sale within the meaning of Article 366(29A) (d) of the Constitution of India. The essence of a 'transfer', is the acquisition of a right by the transferee, and the corresponding loss of it by the transferor. A transfer of the right to use goods depends on who has effective control over the goods. The transaction is squarely covered by BSNL judgment. The 'twin test' specified in this judicial pronouncement i.e. a) transferee has legal right on such goods and to the specific exclusion of transferor; b) transferor again cannot transfer same right to any other person is not fulfilled because MMB can transfer the technology to more than one transferee at the same time. MMB also submitted that this judgment applies to tangible as well as intangible goods. Thus, the transaction is in the nature of grant of permissive use liable to service tax. MMB exercises sufficient control over the technology by means of providing NOC, testing the seeds of sub-licensee and providing approvals which are essential for commercialization of seed by sub licensee.

Further, as held by Supreme Court in various cases, a transaction can be subject to either service tax or a VAT and not both. Thus, the present transaction is liable only to service tax and not VAT. In the petition it was also, prayed that in the event the court held that the transaction is liable to VAT, then the High Court should pass an order directing Union of India to transfer the funds collected in the form of service tax to VAT department directly and not to demand the same from MMB.

The State on the other hand, argued that the effective control is transferred to sub-licensee to the extent of 50 donor seeds through which the technology is transferred and it is the sub-licensees who has the right to use those 50 donor seeds and additional donor seeds produced by sub-licensee as they desire. Further, as per sub-licensing agreement, the sub-licensee is not bound to return to Monsanto any portion of the initial 50 seeds and nor any additional donor seeds produced by him. The control and ownership of the same continues to be with sub-licensee and no permission/approval is required from Monsanto for sale of these seeds to cotton farmers.

The High Court further stated that the BSNL test argued by the taxpayer does not have global or universal applicability and it depends on case to case basis. In the present case, the ratio of BSNL judgment is not applicable. Further the most fundamental aspect of permissive use of goods is that at the end of the period for which the use is granted, the goods must be returned to the transferor. In the present case, the sub-licensee is not bound to return to MMB any portion of the initial 50 seeds given under the agreement nor any additional donor seed that sub-licensee have produced.

Given the above, the High Court has held that the transaction is in the nature of transfer of right to use goods and the same is subject to VAT. Further, with regard to the prayer of transfer of funds from Union to State government, the High Court declined to enter into such debate and left it to MMB to adopt suitable proceedings in this behalf.

Mahyco Monsanto Biotech (India) Pvt Ltd v. the Union of India and others [TS-316-HC-2016(BOM)-VAT]

Payments made to a sub-contractor for works contract, shall not form part of 'total turnover' for purpose of computation of turnover tax

The taxpayer, in the present case, is in the business of engineering and is registered under the

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Karnataka Sales Tax Act, 1957 (Sales Tax Act). The contracts which are secured by the taxpayer are the works contracts and a part thereof, is generally assigned to sub-contractors. Such sub-contractors are also registered under the Sales Tax Act and had submitted returns and paid taxes for the execution of works contract. The taxpayer contended that since the sub-contractors were the parties who executed works contract and the transfer of property in goods involved in execution of works contract had already been taxed in the hands of sub-contractor, the payment made to sub-contractors could not be taken into account while computing total turnover of the taxpayer i.e. main contractor.

The contention of the taxpayer was not accepted by the AO as well as the Karnataka Appellate Tribunal. In the revision petition filed before the Karnataka High Court against the decision of Appellate Tribunal to include the part of works contract executed by the sub-contractors in the total turnover of the taxpayer, the High Court decided against the taxpayer affirming the view taken by the Appellate Tribunal. The taxpayer challenged High Court judgment before the Supreme Court.

The taxpayer specified that sales tax is payable on the transfer of property in goods involved in execution of works contract. Further, the definition of turnover includes the aggregate amount for which goods are bought or sold. Thus, the transfer of property in goods is essential criteria to constitute a sale and also for the calculation of turnover / total turnover. In works contract, the property in goods involved in execution of works contract passes as movable but on the theory of accretion. Further, property is transferred only once by accretion which is taxed as a sale. The taxable person is the sub-contractor executing the works contract and the main contractor who assigns the work to sub-contractor to execute the work, cannot be a transferor, nor any property in goods vest in the main contractor, when the contract is executed by a sub-contractor. Hence, in the present case, there is no sale of goods involved in execution of works contract from sub-contractor to taxpayer. It was also contended that since sub-contractors have executed the works contract and have also paid taxes on such transfer of property in goods involved in execution of works contract, the inclusion of such value in the total turnover of taxpayer would amount to double taxation. In this regard, the taxpayer relied upon the pronouncement of Andhra High Court in its own case wherein it was held that no tax shall be payable on payments made to sub-contractor.

Revenue, on the other hand contended that there is a distinction between ‘taxable turnover’ and ‘total turnover’. As the issue involved herein is related to the turnover tax for which the total turnover becomes relevant i.e. aggregate amount for which goods are bought or sold, without considering any deductions from the turnover on account of payments made to sub-contractor. Accordingly, the payments made to the sub-contractors is also includible in the hands of the taxpayer. Further, the Revenue also contended that the High Court was correct in holding that sales tax is leviable at a single point whereas turnover tax is leviable at a multi-point (both at the hands of the main contractor and sub-contractor) and accordingly, the question of double taxation does not arise.

The Supreme Court held that the total amount paid or payable to the dealer as a consideration for 'transfer of property in goods' which is involved in execution of the works contract, is to be treated as 'total turnover'. Sales tax law specifically restricts the total turnover in respect of those goods only where the property has been transferred and hence, the transfer of property in goods becomes necessary event. Accordingly, unless there is a transfer of property, the amount paid cannot be included in the ‘total turnover’. Further, once the work is assigned by the main contractor to a sub-contractors, the main contractor ceases to execute the works contract as property passes by accretion and there is no property in goods with the contractor which is capable of a retransfer, whether as goods or in some other form. Hence, the amount paid to the sub-contractor is not for transfer of property in goods from sub-contractor to the main contractor i.e. taxpayer.

In view of the above, the Supreme Court held that payments made to the sub-contractors shall not be taken into consideration while computing ‘total turnover’.

Additional Deputy Commissioner of Commercial Taxes v. Larsen and Toubro Limited - [TS-354-SC-2016

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Sale of goods under brand name by fully owned subsidiary/group company of holding entity with unusually high margin, taxable as ‘first sale’

The taxpayer in the present case, is a dealer of home appliances in the state of Kerala on which sales tax is leviable at first point of sale under Kerala General Sales Tax Act, 1963 (KGST Act). The holding company had sold goods to the taxpayer and discharged relevant tax under KGST Act. Subsequently, the taxpayer had sold the same goods in the state of Kerala and did not pay any tax on the same, claiming the benefit of second exemption as tax had already being discharged on such sale of goods at the first point of sale.

The assessing authority in this regard, issued show cause notice, denying the exemption of second sale claimed by the taxpayer and considered same as first sale as such goods were sold under brand name of ‘Sansui’ and held that the taxpayer was the brand name holder. Accordingly, the sale by taxpayer was taxable under provisions of the KGST Act as first point sale and passed an order against the taxpayer.

The Deputy Commissioner (Appeals) rejected the appeal filed by the taxpayer, against which the taxpayer filed an appeal before the Kerala Sales Tax Appellate Tribunal. The Tribunal passed an order in favour of the taxpayer. The State aggrieved by the Tribunal’s order filed for revision petition with the Kerala High Court. A Division bench of High Court allowed the revision petition filed by the State and held that taxpayer is the brand name holder of 'Sansui'. Further, aggrieved by the decision of division bench, the taxpayer filed a review petition with the High Court, which was also dismissed.

Subsequently, the taxpayer preferred an appeal to the Supreme Court by way of Special Leave Petition (SLP), wherein, the taxpayer contended that the company had purchased goods from holding company, who shall be considered as brand name holder and accordingly, relevant tax has been discharged under KGST Act. Hence, taxpayer had correctly claimed the exemption of second sale at the time of further sale of such goods.

On the other hand, the revenue submitted that the taxpayer could not produce any valid evidence to substantiate the contention that the holding company is the brand name holder during the relevant year. Further, it contended that the taxpayer, in the present case, is performing various marketing activities for the products like television, washing machine etc., which are being manufactured under the brand name 'Sansui' and purchased from holding company. Moreover, it was stated that the assessee had used the letter head of ‘Sansui’ for departmental communications. It was further submitted that, one of the most important condition as specified under provisions of KGST Act i.e. ‘the sale is by the brand name holder or the trade mark holder within the State’ was satisfied in the present case as per documentary evidences. Hence, taxpayer is correctly liable to be taxed under KGST Act.

Given the above, the Supreme Court held that the taxpayer is satisfying all the conditions stipulated under KGST Act to constitute the same as first sale in the state of Kerala and accordingly, such sale shall be leviable to tax as the assessee is the brand name holder of “Sansui”. Hence, the SC upheld the decision rendered by HC in revision petition.

State of Kerala v. Kitchen Appliances India Limited- [TS-457-SC-2016-VAT]

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Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

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