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TAX FLASH NEWS

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The AAR accepted the application since the issue was not pending before the tax department

Recently, the Authority for Advance Rulings (AAR) in the case of Centrient Pharmaceuticals Netherlands, B.V[1] (the taxpayer) dealt with the issue of acceptance of an AAR application. The AAR held that there is no bar under the Income-tax Act, 1961 (the Act) to approach the AAR to decide an issue of taxability even if identical receipts were offered to tax by the taxpayer in the earlier years.

There is no stipulation in proviso to Section 245R that if the application is based on change of opinion, such application cannot be admitted. The AAR observed that issue can be said to be pending before the tax department only when return is selected for scrutiny to examine change of stand by the taxpayer or where such change of opinion is examined by the tax department and a considered view regarding such change of opinion is taken after examination.

Facts of the case

The applicant is a Netherland based entity. DSP India (Indian entity) was engaged in the business of manufacturing intermediaries and bulk drugs. The Indian entity had proposed to enter into two service agreements with the taxpayer i.e. Service Level Agreement and IT Support Service Agreement. As per the agreement the taxpayer was to provide the said services to the Indian entity. The employees of the taxpayer company are not to visit India for the same and all the activities will be carried outside India. The applicant filed an application before the AAR to determine taxability of this transaction.

The tax department objected the application on the ground of pendency of issue. It was contended that the return filed for AY 2016-17 was selected for scrutiny prior to filing of the application. The taxpayer had offered amount received from Indian entity as FTS. Since AY 2011-12, the taxpayer was offering such income as FTS. Further a detailed questionnaire was issued to the applicant along with the notice under Section 142(1) for AY 2016-17.

AAR's decision

The service agreement in question was effective from 1 April 2017 and the first year in which services could have been examined by the department was AY 2018-19. However the proceedings pending before the tax department was for AY 2016-17. Further the notice for AY 2016-17 was sent to verify the difference in sales turnover/receipt offered for tax. Since the applicant already offered the receipt on account of services as income, the issue cannot be said as pending before the AO, unless and until one of the reasons for selection of case was to examine the services rendered which is not the case in the present instance. On perusal of questionnaire for AY 2016-17, the AAR observed that the questions raised in the application were not pending in the scrutiny assessment of AY 2016-17.

The AAR held that there is no bar under provisions of Act to approach AAR to decide issue of taxability even if identical receipts were offered to tax by the taxpayer in the earlier years. Further, there is no stipulation in proviso to Section 245R that if the application is based on change of opinion, such application cannot be admitted. It is relevant to consider whether such change of opinion renders the issue as 'pending' before the tax department for the earlier years. The AAR observed that issue can be said to be pending before the tax department only when return is selected for scrutiny to examine change of stand by the taxpayer or where such change of opinion is examined by the tax department and a considered view regarding such change of opinion is taken after such examination. When examined on these parameters, matter can't be said to be pending before the tax department because return for relevant assessment year was not selected for scrutiny to examine any change of stand in manner of offering of any particular income. The change of stand by the applicant is to be examined on the basis of merits.

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[1] Centrient Pharmaceuticals Netherlands, B.V. AAR No. 01 of 2018 (New Delhi) – Taxsutra.com

Therefore, there is no pendency in respect of the questions raised in the present application before the tax department. Further, as the taxpayer had already offered the amount for services rendered as royalty/FTS, there was no occasion for the AO to examine this change of stand.

The AAR relied on the decision of the Delhi High Court in the case of Hyosung Corporation[2] where it was held that a notice issued under Section 143(2) merely asking for certain information from the taxpayer prior to filing of application before the AAR will not constitute bar in terms of clause (i) to proviso to Section 245R(2), on entertaining and allowing the application. The AAR applied the same principle in respect of the notice issued under Section 142(1). Therefore, such notices issued prior to filing of the application cannot be a bar in terms of clause (i) to proviso to Section245R(2) of the Act.

Thus, issues involved in questions raised in application filed before AAR was not pending before the tax department, in terms of clause (i) of proviso to Section 245R(2) was not attracted. Accordingly, the application was admitted.

Our comments

The issue with respect to acceptance of AAR application has been a matter of debate before Courts/Tribunal.

The Delhi High Court in the case of Hyosung Corporation held that that a notice issued under Section 143(2) merely asking for certain information from the taxpayer prior to filing of application before AAR will not constitute bar in terms of clause (i) to proviso to Section 245R(2), on entertaining and allowing the application.

The AAR in the instant case has admitted the appeal and held that it is relevant to consider whether change of opinion renders the issue as 'pending' before the tax department for the earlier years. The AAR observed that issue can be said to be pending before the tax department only when return is selected for scrutiny to examine change of stand by the taxpayer or where such change of opinion is examined by the tax department and a considered view regarding such change of opinion is taken after such examination. In the instant case, there was no pendency in respect of the questions raised in the present application before the tax department.

It is pertinent to note that the Finance Bill 2021 has proposed to discontinue the AAR mechanism. The Bill proposed that the Central Government will constitute one or more Board for Advance Rulings (BAR). All pending applications are to be transferred from AAR to BAR. BAR will consist of two members, not below the rank of Chief Commissioner and its rulings will not be binding on the applicant or the tax department.

However, based on the proposed changes, it seems that the overall modus operandi of the AAR mechanism may remain same. Therefore, the principle laid down by the instant decision read with the Delhi High Court decision may equally apply during the BAR regime.

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

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