Nangia Andersen LLP

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Direct Tax

1

ITAT: Income from supply of equipment taxable in India as Indian Subsidiary constituted Permanent Establishment of the assessee in India

Issue: Permanent Establishment (PE)
Outcome: Against the assessee

Background

In the case of Huawei Technologies Co. Ltd (the assessee), the Delhi Bench of Income-tax Appellate Tribunal (ITAT) dealt with the taxability of income from supply of telecommunication network equipment, its installation and commissioning. The ITAT ruled that the income from the supply of equipment was taxable in India as the Indian subsidiary not only constituted Dependent Agent PE (DAPE) of the assessee but also Service PE and Fixed Place PE in accordance with Article 5 of the India-China tax treaty.

Brief Facts and Contentions

- The assessee, a China based entity, had a subsidiary in India (Huawei India/ the Indian subsidiary) and was engaged in the business of supplying non-terminal products (i.e. advanced telecommunication network equipment) and terminal products (i.e. mobile phone handsets) to various customers (including customers in India).
- For the assessment years 2009-10 to 2016-17, the assessee provided integration, installation and commissioning services in relation to telecom network equipment supplied from outside India to the Indian subsidiary under the terms of Technical Service Agreement.
- The assessee offered revenue accrued from technical services provided to the Indian subsidiary on gross basis and paid taxes in accordance with the provisions of Article 12 of the tax treaty.
- The assessee also earned revenue from sale of telecom network equipment and terminal equipment/mobile handsets but did not offer that revenue for taxation in India.
- A survey was conducted at the premises of the Indian subsidiary, during which, several incriminating documents were obtained and statements of various senior executives were recorded.
- The assessee was of the view that income from supply of equipment to telecom service providers in India, qualified as business profits and in the absence of PE in India, was not taxable. The assessee contended that supply contracts with Indian customers were concluded through electronic means and through short visits of the assessee's personnel at customer locations in India and that all contracts were accepted and concluded by the assessee outside India. Therefore, the assessee did not have a Fixed Place PE in India.
- It was also explained that the assessee did not constitute a DAPE in India on account of the fact that the power to negotiate, decide, vary and accept the terms of the supply contract on behalf of the assessee vested with the Board of Directors of the assessee, who resided in China.
- It was also asserted the assessee did not constitute a service PE/ Installation PE in India as the market support provided under the service agreement were preparatory and auxiliary in nature and that the Indian subsidiary rendered other services on its own account and not on behalf of the taxpayer
- However, based on the statements of senior employees, analysis of survey documents, agreements and submissions of the assessee, the AO held that the assessee had a business connection in India and constituted a Fixed Place PE, DAPE, Service and Installation PE in India.
- Aggrieved, the assessee pleaded its case before the ITAT.

ITAT's Judgement

Business Connection

The ITAT noted that real and intimate relationship existed between the assessee and the Indian subsidiary as the sale of telecommunication network equipment served no purpose of a buyer unless the telecommunication network equipment were installed and commissioned and this was done by the Indian subsidiary. This contributed directly to the revenue of the assessee, even if sale transaction has been concluded outside India

Further, the ITAT observed that the assessee continued to undertake the risk of rejection of the supply in India and therefore, there was extension of business of the assessee in India in respect of the supply of equipment to India.

Fixed Place PE

Relying on the ruling of the Supreme Court in the case of Formula One World Championship Limited[1], the ITAT derived that *control and disposal go hand-in-hand. Therefore, disposal of fixed place is determined by the degree of control exercised by the foreign entity.* Frequent visits from the expats from Huawei China exert the control to carry out various business activities of the foreign assessee.

Therefore, it was held that the Indian subsidiary constituted Fixed Place PE of the assessee in India as the premises were at the disposal of the assessee's employees.

DAPE

Based on email correspondence of the Indian subsidiary's employee, the ITAT noted that Indian resources were involved in negotiation of deals on behalf of the taxpayer and were also a part of the joint bidding team and therefore, the ITAT concluded that the assessee had a DAPE in India.

Service/ Installation PE

The ITAT observed the facts on record that showed that foreign experts in technology were present in India on site in order to supervise the installation and commissioning process. The assessee had itself contended that the Indian subsidiary was not equipped to do installation and commissioning on its own.

The act of installation had been performed only with the supervision of assessee's resources, which meant that supply and installation were integral and not merely preparatory/ auxiliary in nature. Therefore, the ITAT held that the activity of supervision (exceeding 183 days), in connection with the installation constituted Installation PE of the assessee as per the India-China DTAA

Due to the secondment of employees of the assessee for the purpose of supervision, the ITAT held that there existed a Service PE of the assessee India.

Nangia Andersen LLP's Take

The Delhi ITAT in the instant case has gone into the depths of the facts and material on record to conclude that the income from the supply of equipment is taxable in India and that the taxpayer had a Service, Agency and Fixed Place PE in India. Observing that the Indian subsidiary was economically dependent on the assessee and that the assessee closely monitored the activities right from bidding to installation, the ITAT established that the assessee had a PE in India. The ITAT immaculately analyzed the facts in totality (including email correspondences of employees) to reach to conclusion that there was extension of the assessee's business in India in respect of supply of equipment in India.

Past Precedents on the issue

In the case of JC Bamford Excavators Ltd.[2], it was held that where in pursuance of Technology Transfer Agreement, assessee deputed employees to Indian subsidiary for managing its overall operations, and those employees rendered managerial and technical services in India for more than the specified period, it constituted assessee's service PE in India in terms of the relevant DTAA. Thus, payments made in respect of services rendered by them would be taxable as business profits in terms of article 7 of India-UK DTAA.

Source: [TS-638-ITAT-2020(DEL)]

[1] Formula One World Championship Ltd. V. CIT [2017] 80 taxmann.com 347 (SC)

[2] IT APPEAL NO. 540 (DELHI) OF 2011

2

Karnataka High Court allows ESOP discount as deductible business expenditure

Issue: Discount on the issue of ESOPs- business expenditure
Outcome: In favour of the assesse

Background

The Karnataka High Court (HC) in the case of Biocon Ltd. (the assessee) ruled on the issue of allowability of discount on issue of Employees Stock Option Plans (ESOPs) as a business expenditure. The HC noted that the expression 'expenditure' would also encompass losses and consequently, issuance of shares at a discount where the assessee absorbs the difference between the issue price and the market value of the shares would also be treated as an expenditure incurred for the purpose of business.

Brief Facts and Contentions

- The assessee, engaged in the business of manufacturing enzymes and pharmaceuticals, floated ESOPs and constituted a trust under a scheme. The shares of the company were transferred to the trust at the face value and the employees of the company were allowed to exercise the option to buy the shares within prescribed time.
- The ESOPs vested in the employees over a period of four years at the rate of 25 per cent each year, implying that at the end of first year, the employees had a definite right to 25 per cent of the shares and Biocon Ltd. was bound to allow the vesting of 25 per cent of the options.
- During the Assessment Year 04-05, the assessee claimed the difference of market price and issue price as expenditure under Section 37 of the Income- tax Act (the Act)
- The Assessing Officer (AO) rejected the claim stating that the assessee had not incurred any expenditure and that the discount was contingent and hence, the taxpayer was not entitled to claim the same as deduction under Section 37 of the Act. The Commissioner of Income Tax (Appeals) upheld the order of the AO.
- The Assessee argued that the discount on issue of ESOP was not contingent and that for deduction as business expense, it is sufficient that the expenditure has been incurred. Therefore, issuance of shares at a discount where the assessee absorbs the difference between the price at which it is issued and the market value of shares would also qualify as expenditure for the purpose of deduction under Section 37 of the Act.
- On appeal, the division bench of the ITAT referred to the Special Bench of the ITAT in view of conflicting decisions on the issue. The Special Bench of the Tribunal ruled in favour of the assessee on the grounds that the expenditure was not contingent in nature and that the difference between the market value and the value at which shares were allotted, was part of remuneration, which was paid to the employees as compensation for the continuity of services to the company. Hence, the same was allowable as an expenditure under Section 37 of the Act.
- Aggrieved by the decision, the Revenue appealed before the High Court

High Court's Judgement

The HC ruled that the expression ''expenditure'' used in Section 37 does not require pay out in cash and the difference between the market price and the issue price of shares under the ESOP scheme is a deductible expenditure the said section.

The key observations were as follows:

- The provisions of Section 37 are attracted when an "expenditure" has been incurred. The expression ''expenditure'' also encompasses any losses incurred. Further, the provisions of the said section do not explicitly contain any requirements of pay out or envisage any incurrence of expenditure in cash.
- The HC noted that in order to be eligible for acquiring shares, under the scheme, the employees are under obligation to render their services to the company during the vesting period as provided under the scheme.
- The HC concurred with the ruling of the Supreme Court in case of Bharat Earth Movers[1] and Rotork Controls India[2] that discount on issue of ESOPs is not a contingent liability but is an ascertained liability.
- The HC also pronounced that the primary object of issuing ESOPs was not to waste capital but to earn profits by securing consistent services of the employees. Further, when a business liability arises in an accounting year, the same is permitted as a deduction, even though, liability may have to be quantified and discharged at a future date. So the exercising of options by employees is only a quantification of liability taking place at a future date.
- The HC also noted that the deduction of discount on ESOP over the vesting period was in accordance with the accounting in the books of accounts, which had been prepared in accordance with SEBI (Employees Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.
- HC followed the judgement of the Apex Court in case of Radhasoami Satsang[3] to stipulate that that since Revenue has allowed deduction of ESOP expenses from AY 2009-10 onwards in assessee's own case, it cannot take a different stand with regard to the assessment year in question.
- The HC concluded that the *assessee had incurred a definite legal liability and on following the mercantile system of accounting, the discount on ESOPs has rightly been debited as expenditure in the books of accounts.*

Nangia Andersen LLP's Take

Owing to the lack of a specific provision under law, the divisive issue has been subject to colossal litigation over the years. The diverse views over the issue have complicated the matter even more and have made compliance difficult.

This favourable judgement offers respite to the taxpayers in the form of allowance of discount on issue of ESOP as business expenditure based on the accounting treatment laid out in the SEBI guidelines. The Karnataka HC has ruled that the difference between the market price and the issue price of shares under the ESOP scheme is a deductible expenditure under section 37, correctly emphasizing that the expression 'expenditure' also encompasses losses incurred and that the provisions of said section do not necessitate pay-out or incurrence of expenditure in cash.

Past Precedents on the issue

- The Madras High Court, in the ruling ''CIT v. PVP Ventures Ltd''[4] upheld the proposition that the ESOP cost charged to the profit and loss (P&L) account in accordance with the accounting policies prescribed by the Securities Exchange Board of India (SEBI) guidelines was not a notional or contingent liability. Likewise, the Supreme Court held the same decision in the case of Bharat Earth Movers and Rotork Controls India Pvt. Ltd. In the case of Radhasaomi Satsang v. CIT, the Supreme Court permitted the deduction of ESOP expenses. These cases have been relied upon in the instant case.
- In the case of Ranbaxy Laboratories Ltd v. ACIT [2009], however, it was ruled that the difference between the market price and the issue price of the shares offered under the ESOP scheme is not an allowable expenditure since such loss incurred is a notional loss.

Source: ITA no 653 of 2013]

[1] (2000) 112 Taxmann 61 (SC)

[2] (2009) 180 Taxmann 422 (SC)

[3] (1992) 193 ITR 321 (SC)

[4] 23 taxmann.com 286 (MAD)

3

Karnataka High Court: No TDS on reimbursement of expenses to non-residents

Issue: Deduction of tax at source (TDS) / Fee for Technical Services (FTS) / Reimbursement
Outcome: In favour of the assessee

Background

In the case of Abbey Business Services India Pvt Ltd (the assessee), the Karnataka High Court (HC) upheld the order of the Income Tax Appellate Tribunal (ITAT) that the reimbursements to non-resident of hotel and travelling expenses incurred by seconded employees were not in the nature of FTS and consequently, not liable for deduction of tax at source.

Brief Facts and Contentions

- The assessee was an Indian company and a subsidiary of a group company of Abbey National Plc, UK (ANP/ UK Company). ANP entered into an agreement with Msource India Private Limited for outsourcing of certain services and call centres.
- As per the agreement, Msource India was required to provide high quality service that supported the position of the UK Company and its affiliates as well as to customers in UK.
- For the purpose of facilitation of outsourcing agreement between ANP and Msource India and for ensuring that Msource India renders high quality service, ANP entered into a consultancy agreement with the assessee and also an agreement for secondment of ANP's employees to the assessee.
- During the relevant assessment year, the assessee made certain payments to the UK Company for deputation of employees, in respect of hotel expenses, travelling expenses and salary reimbursements. The assessee withheld tax on the part of the amount paid as salary reimbursements. However, it did not withhold tax from the amount paid in respect of hotel and travelling expenses believing that the same were not technical in nature.
- The Assessing Officer (AO) observed that ANP's seconded employees were highly skilled technical personnel and ANP had agreed to provide training to some of the employees of Msource India. He therefore concluded that the amount on which tax was not deducted was in fact payment in respect of FTS as per the Income-tax Act as well as under the India-UK tax treaty.
- Further, the AO also rejected the contention of the assessee that there was no nexus between ANP and the provision of services by the expatriates on account of the fact that the employees were on the payroll of UK Company.
- On appeal, the CIT (A) held in favour of the Revenue. However, Bangalore ITAT held that there was no obligation on the part of the assessee to deduct tax at source on payments made to ANP and therefore, the assessee cannot be treated as 'assessee in default' under Section 201 of the Act. Aggrieved, Revenue filed an appeal before the Karnataka HC.

High Court's Judgement

The Karnataka HC ruled in favour of the assessee. The key observations and conclusions are as follows:

- After thorough examination of the secondment agreements, the HC derived that it was evident that the assessee had entered into a secondment agreement for securing services to assist the assessee in its business.

- The ITAT found it pertinent to note that the secondment agreement constituted an independent contract of services in respect of employment with the assessee

  The HC observed that the seconded employees had to work at such place as instructed by the assessee and had to function under the control, direction and supervision of the assessee and in accordance with policies, rules and guidelines applicable to the employees of the assessee. Further, the employees in their capacity as employees of the assessee had to control and supervise the activities of Msource India.

- Based on these facts, the HC ruled that the assessee had to be treated as an employer of the seconded employees.

- It was opined that *there was no obligation in law for deduction of tax at source on payments made for reimbursement of costs incurred by a non-resident enterprise,* therefore, the amount paid by the assessee was not to suffer TDS under section 195 of the Act. The HC also relied on the ruling of HCL Info System Limited[1], wherein similar view was taken.

- The HC also distinguished the ruling in the case of Centrica India[2], elucidating that the instant case did not involve the issue of Permanent Establishment.

Nangia Andersen LLP's Take

TDS on reimbursement of expenses has been litigious issue and decisions by various appellate authorities are made considering the factual matrix of each case. This ruling fairly enunciates that reimbursements to non-residents for hotel and travelling expenses incurred by seconded employees are not in the nature of FTS and consequently, not liable for deduction of tax at source.

Past Precedents on the issue

In the case of Mark & Spencer Reliance India (P.) Ltd.[3], it was held that expatriation of employees under seconded agreement without transfer of technology would not fall under term 'make available' as per Indo-UK DTAA, and therefore, payment made by assessee towards salary expenditure of employees deputed to assessee under seconded agreement could not be considered as FTS.

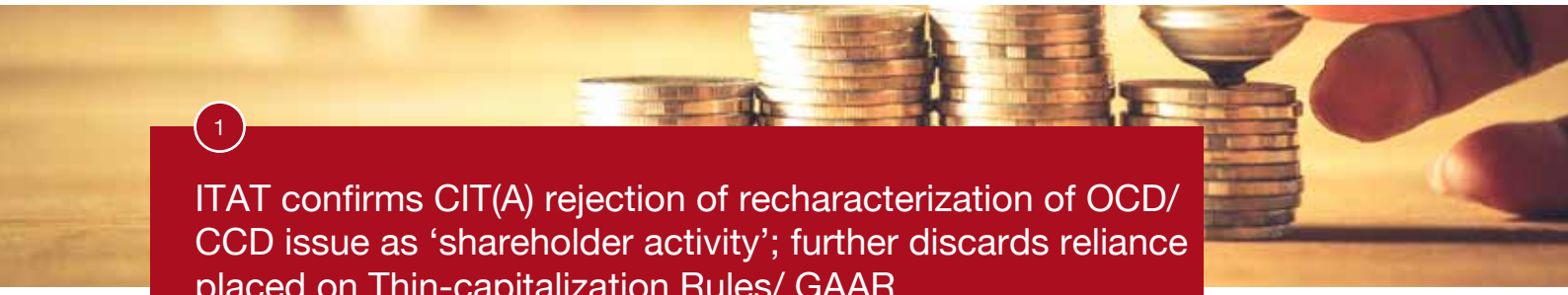
[Source: ITA No 214 of 2014]

[1] 274 ITR 261 (Delhi)

[2] WP (C) No 6907/2012

[3] IT Appeal No. 905 (MUM.) OF 2012

Transfer Pricing



1

ITAT confirms CIT(A) rejection of recharacterization of OCD/ CCD issue as 'shareholder activity'; further discards reliance placed on Thin-capitalization Rules/ GAAR

Issue: In favour of both revenue and taxpayer
Outcome: Treatment of OCD/CCD, Interest on Debentures

Brief Facts and Contentions

- Kolte Patil Developers Ltd ("the taxpayer") is engaged in the business of development of real estate. During the AY 2013-14, the taxpayer had issued Compulsory Convertible Debentures ("CCDs") and Optionally Convertible Debentures ("OCDs") to its Associated Enterprises ("AEs") in India and Abroad and the total interest payment of INR 6.32 crores was claimed as deduction. The Assessing Officer ("AO") made a reference to Transfer Pricing Officer ("TPO") for Arm's Length Price ("ALP") determination of the aforesaid issuance of CCDs/OCDs.

- **Issue 1: Treatment of Optionally and Compulsory Convertible Debentures issued by the taxpayer as Equity Share Capital:**

  - The TPO asked the taxpayer to show-cause as to why the transaction of issue of debentures to AEs by the taxpayer not be considered as issue of shares. Further, TPO considered the aforesaid transaction as a 'Shareholder activity' by finding that the availment of funds by the taxpayer from its AEs was through hybrid instruments as these were convertible into shares.

  - TPO further held that no independent third party would have invested in the convertible debentures issued by the taxpayer except by way of participation in equity and took note of the 'Thin Capitalization Principle' and 'General Anti-Avoidance Rules' ("GAAR").

  - Aggrieved by the order of TPO, the taxpayer appealed before the CIT(A). The CIT(A) rejected TPO's order of re-characterizing the transaction of issuance of OCDs/CCDs into Equity Capital.

- **Issue 2: Benchmarking of International Transaction/SDT of interest payment to AEs @15%:**

  - TPO noted that the taxpayer paid interest @ 15% on CCDs and OCDs issued to its AEs and held that the amount so raised by the taxpayer had a substance of equity on which no interest was payable and hence determined NIL ALP for transaction pertaining to payment of interest on debentures, thereby proposing a TP adjustment of INR 6.32 crores.

  - Thereafter, CIT(A) relied on taxpayer's own order for AY 2011-12, determining ALP interest rate at 13.75% on the basis of interest paid by the taxpayer to its banker as a comparable uncontrolled transaction. Hence, the TP adjustment by CIT(A) was restricted to 1.25% of the value of transactions.

- Aggrieved, both, taxpayer and Revenue filed an appeal before the Hon'ble Income Tax Appellate Tribunal ("ITAT").

ITAT's Ruling

ITAT relied on the contentions of the taxpayer and the Revenue and made the following observations:

- **Issue 1: Treatment of Optionally and Compulsory Convertible Debentures issued by the taxpayer as Equity Share Capital:**

  - ITAT confirmed CIT(A)'s rejection of re-characterization of CCDs and OCDs issued by the taxpayer to its AEs as Equity Share Capital as the CCDs and OCDs issued were redeemed and not converted into equity shares. ITAT further rejected TPO's determination of issue oof debentures as 'shareholder activity'

and noted that these activities are performed by a parent company SOLELY because of its shareholding in other group companies.

- ITAT further rejected TPO's application of thin capitalization rules enshrined in Section 94B of the Income Tax Act, 1961 and GAAR provisions, for changing the complexion of transaction from borrowing to equity. The relevant provisions in this regard came into force w.e.f. 1.4.2018 and hence, were inapplicable for the year under consideration. Reliance was placed on HC ruling in Besix Kier Dabhol SA, wherein it was held that in absence of any specific thin capitalization rules in India, AO could not disallow the interest payment on debt capital after having observed the abnormal thin capitalization.

- ITAT also opined that Chapter X requires re-determining the ALP of the transaction actually entered and does not call for re-determining the nature of transaction entered into between two related enterprises.

- **Issue 2: Benchmarking of International Transaction/SDT of interest payment to AEs @15%:**

  - ITAT held that the rate of interest to be taken into consideration is the rate payable in India since the taxpayer is the recipient of the loan in the form of debentures. In this regard, reliance was placed on HC ruling in *Tata Autocomp Systems Ltd [TS-45-HC-2015(BOM)-TP] and India Debt Management P. Ltd,* wherein it was held that where loans are advanced to AEs, ALP should be determined on the basis of rate of interest being charged in the country where loan is received.

  - ITAT further observed that CIT(A)'s decision for AY 2011-12, where internal comparable for interest payment by the taxpayer to IDBI as a benchmark was considered, finality under the Vivad Se Vishwas Scheme had been attained.

  - ITAT noted that the amount payable to IDBI bank stood at NIL in the financial statements of the taxpayer which showed that the interest rate paid by the taxpayer to IDBI Bank which was considered as an internal comparable under CUP method for earlier AY, was no more relevant for concerned AY and ALP determination has to be undertaken for each year separately by considering the facts and circumstances relevant to the issue for that particular year. Accordingly, ITAT remitted the issue back to the AO/TPO for fresh ALP determination.

Nangia Andersen LLP's Take

In the instant ruling, rejection of re-characterization of transaction pertaining to issue of debentures as issue of equity shares and further rejection of categorization of such transaction as a shareholder activity is a welcome step. The same would result in a tax saving as interest paid on debentures is allowed as a deductible expense as against payment of dividend, which is disallowed for deduction.

Further, ITAT has reiterated that Chapter X simply provides for determination of ALP rather than re-determination of the nature of transaction or re-characterization of transactions.

ITAT further stated that while BEPS Action Plan 4 and Thin Capitalization Rules were introduced in India to provide a limit on deductible interest at 30% of earnings before interest, taxes, and depreciation (where payment of interest exceeds INR 1 crore), it also highlighted that Thin Capitalization rule and GAAR have only been brought in the statute prospectively w.e.f 1st April 2018 and accordingly, the aforesaid provisions shall not be applicable retrospectively.

In respect of the internal CUP applied by the CIT(A) in order to determine the arm's length interest rate on CCD/OCD, the ITAT stated that it is imperative to determine the ALP for each year separately by considering the facts and circumstances relevant to the issue for that particular year instead of relying on internal comparables without considering the updated facts.

It is therefore recommended that the taxpayers maintain robust documentary evidences to avoid ad-hoc transfer pricing adjustments resulting in unnecessary financial burden to the taxpayers.

Source: Kolte Patil Developers Ltd (erstwhile Bellflower Properties Pvt Ltd merged with Kolte Patil Developers Ltd) [TS-655-ITAT-2020(PUN)-TP]

2

ITAT: Compliance of Accountants Report u/s 92E is not substitute of Documentation u/s 92D.

Issue: In favour of revenue
Outcome: Penalty for non-maintenance of documents u/s 92 D.

Brief Facts and Contentions

- **Convergys Customer Management Group Inc. ("the taxpayer"), a USA based non-resident company, filed a miscellaneous application seeking rectification of mistakes apparent in the Tribunal order for AY 2006-07 and 2008-09 pertaining to levy of penalty u/s 271AA.**
- TPO had levied penalty for failure to maintain and furnish documents u/s 92D, which was deleted by CIT(A) and on appeal by Revenue, Tribunal upheld the levy of penalty. **Subsequently the taxpayer filed miscellaneous application seeking rectification of the ITAT order.**
- Before the ITAT, taxpayer claimed the following via miscellaneous application:
  - Tribunal did not adjudicate on taxpayer's argument that all relevant documents u/s 92D read with rule 10D were maintained and no TP adjustment was made in its case,
  - Tribunal observed that taxpayer should have obtained a report from an Independent Accountant in respect of the international transactions while the taxpayer had obtained such a report in Form 3CEB and filed along with return,
  - Tribunal observed that even if there is no international transaction, documents u/s. 92D is to be maintained for Specified Domestic Transaction (SDT) whereas taxpayer, being a non-resident there cannot be any case of SDT,
  - taxpayer's plea that AO had not brought in any specific requirement as to which documents have not been maintained, was not considered by Tribunal
- On the other hand, Revenue contended that taxpayer is seeking a review of its own order, which is not permissible under the provisions of the law.

ITAT's Ruling

- ITAT emphasized that Form 3CEB are to be furnished according to Sec. 92E and different set of documents are to be maintained u/s 92D. Thus, the mere submission of Form 3CEB with accountant's report will not be treated as documents submitted under Section 92D of the Act;
- ITAT explained that although the transactions in the nature of reimbursement of software payments and payments of interest and FTS were not taxable in India as per India- US DTAA, however the same ought to be disclosed in Form 3CEB;
- ITAT observed that a categorical finding was given by the coordinate bench that every person has to maintain its own documents which taxpayer failed to and instead relied on its India subsidiary's TP study, states that *"If the assessee as per the mandate of Section 92C would have maintained its own documents relating to the TP adjustment, the Assessing Officer would have properly been able to determine ALP of the international transactions"*
- Factually, ITAT distinguished the case law of Bebo Technologies [TS-254-ITAT-2013(CHANDI)-TP] relied on by taxpayer and highlighted that the Tribunal in the said case deleted the penalty on the ground that show cause notice was not issued before passing the order under Section 271AA.

In view of the aforementioned, ITAT stated ***"A mistake apparent on the record must be an obvious and patent mistake and not something which can be established by a long-drawn process of reasoning on points which were not emerging from the original facts of the case."*** and concluded that taxpayer is not permitted to seek review of its own order by Tribunal.

Nangia Andersen LLP's Take

The instant ruling is an alarm for Foreign entities dealing with or receiving payments from Indian AEs as the ruling clearly elucidates the importance of disclosing all international transactions in Form 3CEB irrespective of whether the transactions are taxable in India or not as per India- US DTAA.

The ruling reiterated the importance of separate TP documentation by foreign entity & held that reliance on the documentation maintained by the Indian subsidiary is insufficient in the case of foreign entity bench-marking. The tax authorities highly emphasise on the maintenance of proper TP documentation by Foreign Entity on the fact that the requirement of TP documentation u/s 92D of the Act cannot be substituted with furnishing Accountants Report u/s 92E of the Act.

In view of the aforementioned, it is recommended that the foreign entities dealing with or receiving payments from Indian AEs should maintain proper TP documentation and ensure TP compliance in order to avoid any penal implications from the Indian TP perspective.

Source: Convergys Customer Management Group Inc. [TS-690-ITAT-2020(DEL)-TP]

Regulatory

1

Financial Services Updates

I. Opening of Second Cohort under the Regulatory Sandbox

In order to encourage innovation in the financial services sector, the Reserve Bank of India ('RBI') vide Press Release dated December 16, 2020 has announced opening of Second Cohort under the Regulatory Sandbox with 'Cross Border Payments,' as its theme.

Regulatory Sandbox is a framework which allows for live testing of new products or services in a controlled environment for which RBI may offer certain regulatory relaxations for the limited period of testing. In other words, it is an important tool which enables more dynamic, evidence based regulatory environment to evolve with emerging technologies.

The applicants intending to enter Regulatory Sandbox have to adhere to the eligibility criteria as prescribed below:

- Applicant can only be FinTech companies including startups, banks, financial institutions, any other company, Limited Liability Partnership (LLP) and partnership firms, partnering with or providing support to financial services businesses
- The entity shall have a minimum net worth of ₹10 lakh as per its latest audited balance sheet
- All the promoter(s)/director(s)/Partner(s) of the entity should be fit and proper persons
- The conduct of the bank accounts and credit history of the entity as well its promoters/directors should be satisfactory
- The credit history of the promoter(s)/director(s)/ entity shall be satisfactory.

Most importantly, the proposed FinTech solution should highlight an existing gap in the financial ecosystem and the proposal should demonstrate how it would address the problem and bring benefits to consumers or the industry and/or perform the same work more efficiently.

The window for submission of applications is opened from December 21, 2020 to February 15, 2021.

II. Authorisation of Entities for Operating a Payment System Under The Payment And Settlement Systems Act, 2007 ('Pss Act') – Introduction Of Cooling Period

To inculcate discipline and encourage submission of applications by serious players as also for effective utilization of regulatory resources, the Reserve Bank of India ('RBI') has introduced the concept of Cooling Period.

During the Cooling Period, entities shall be prohibited from submission of applications for operating any payment system under the PSS Act.

According to the provisions of the Payment and Settlement Systems Act, 2007 ('PSS Act') and 'Oversight Framework for Financial Market Infrastructures and Retail Payment Systems' issued on June 13, 2020, any person before commencing or operating a payment system requires to obtain authorization from RBI.

Now RBI has introduced a cooling period for a period of one year from the date of revocation/non-renewal/ acceptance of voluntary surrender/rejection of application in the following situations:

- Authorised Payment System Operators (PSOs) whose Certificate of Authorization (CoA) is revoked or not renewed for any reason; or
- CoA is voluntarily surrendered for any reason; or
- Application for authorization of a payment system has been rejected by RBI.
- New entities that are set-up by promoters involved in any of the above categories; definition of promoters for the purpose, shall be as defined in the Companies Act, 2013.

Iii. Perpetual Validity for Certificate of Authorisation ('COA') issued to Payment System Operators (PSOs) under Payment and Settlement Systems Act, 2007 ('PSS Act')

According to the Statement on Developmental and Regulatory Policies, Reserve Bank of India ('RBI') had announced granting of authorization for all Payment System Operators ('PSOs') under PSS Act on a perpetual basis.

Currently, RBI grants authorization to entities desirous of operating a payment system (both new and existing) for specified periods up to five years.

To reduce licensing uncertainties and enable PSOs to focus on their business as also to optimize utilization of regulatory resources, RBI has decided to grant authorization for all PSOs (both new and existing) on a perpetual basis.

For existing authorised PSOs, grant of perpetual validity shall be examined as and when the Certificate of Authorization ('CoA') becomes due for renewal.

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Updates under FEMA

Facilitation of External Trade - Export of Goods and Services

With a view to further enhance the ease of doing business and quicken the approval process, the Reserve Bank of India ('RBI') on December 04, 2020 has announced several measures pertaining to external trade to enhance the export competitiveness of the country. According to the notification, RBI has decided to delegate powers to the AD Bank in the following areas:

I. Direct Dispatch of Shipping Documents

In terms of extant Master Circular on Export of Goods and Services, AD banks normally dispatch shipping documents to their overseas branches/correspondents expeditiously. However, if the exporter has directly dispatched the documents to the consignee or his agent, AD banks could regularize these cases where the value per export shipment is up to USD 1 million subject to the applicable conditions.

With a view to simplify the procedures, it has been decided to do away with this limit of USD 1 million. Therefore, AD banks can now regularize such direct dispatch of shipping documents irrespective of the value of export shipment subject to conditionalities.

II. Write-off of Unrealized Export Bills

In terms of extant Master Circular on Export of Goods and Services, 15% of the total export proceeds could be written-off subject to the approval of the AD Bank on fulfilling the applicable conditions.

According to the measures announced on December 04, 2020, AD bank may, on request of the exporter, write-off unrealized export bills without any limit in respect of following cases provided AD bank is satisfied with the documentary evidence produced.

III. Set-off of Export Receivables against Import Payables

Presently, AD Banks are authorized to allow exporters/ importers to set off export receivables against import payables and vice versa from same overseas buyer – supplier only. With a view to facilitate trade transactions, RBI has delegated power to AD Banks to set off with group/ associate companies of importers/ exporters provided the arrangement shall be backed by a written, legally enforceable agreement/contract.

IV. Refund of Export Proceeds

In terms of extant Master Circular on Export of Goods and Services, the AD banks are authorized to consider refund requests from exporters only in cases where goods are being re-imported to India on account of poor quality. There was no such provision to allow remittance of refund where exported goods have been auctioned or destroyed in the importing country. The instructions have been reviewed and henceforth, AD Banks are allowed to permit refund in such cases subject to receipt of satisfactory documentary evidence from exporter. Further, AD Banks are also required to:

- Exercise due diligence on the track record of the exporter
- Verify the bona-fides of the transactions
- Obtain a certificate issued by DGFT/Custom authorities that no export incentive has been availed of by the exporter against the relevant export or the proportionate export incentives availed, if any, have been surrendered

3

Companies Act Updates

I.Companies (Share Capital and Debentures) Second Amendment Rules, 2020

The Ministry of Corporate Affairs ("MCA") via notification dated December 24, 2020 has modified Form SH-7 regarding alteration of share capital.

The revised form now provides for a radio button for "***cancellation of unissued shares of one class and increase in shares of another class"***

II. Commencement of Various Provisions of the Companies (Amendment) Act, 2020

The Ministry of Corporate Affairs has enforced few of the provisions of the Companies (Amendment) Act, 2020 w.e.f. 21st December, 2020.

These provisions pertain to the penal provisions such as removal of imprisonment/ penalty, re-categorization of offences and winding up.

III. Companies (Appointment and Qualification of Directors) Fifth Amendment Rules, 2020

The Ministry of Corporate Affairs vide notification dated 18th December 2020 has relaxed Online Test Requirement for Independent Directors.

The key highlights of the notification are as follows:

- Every individual whose name is so included in the data bank shall pass an online proficiency self-assessment test conducted by the Indian Institute of Corporate Affairs (IICA) within a period of 2 years instead of 1 year from the date of inclusion of his name in the data bank
- The passing criteria of the online proficiency self-assessment test has been reduced to 50% from 60%
- Amendment has broaden the exemption criteria for an Individual to take online proficiency self-assessment test. Now, an individual shall not be required to pass the online proficiency self-assessment test when he has served as a Director or Key Managerial Personnel (KMP) in a listed public company or in an unlisted public company having a paid-up share capital of rupees 10 crores or more for a total period of not less than 3 years instead of 10 years

IV. The Companies (Incorporation) Third Amendment Rules, 2020

In terms of Section 4 (5) of the Companies Act, 2013, name of the Company is available only for 20 days and once it expires, it has to be re-applied afresh.

MCA has now amended Companies incorporation rules, by insertion of Rule 9A, to allow extension of reservation of cases up to 60 days. The extension can be sought in the following ways:

(a) 40 days from the date of original approval on payment of fees of Rs. 1000 before the expiry of 20 days **(FIRST EXTENSION OF 40 DAYS)**

(b) 60 days from the date of original approval on payment of fees of Rs. 2000 before the expiry of above 40 days **(SECOND EXTENSION OF 20 DAYS)**

OR

(c) 60 days from the date of original approval on payment of fees of Rs. 3000 before the expiry of 20 days **(DIRECT EXTENSION OF 60 DAYS)**

The extension provisions are applicable from **January 26, 2021.**

V. Companies (Meetings of Board and its Powers) Fourth Amendment Rules, 2020

Due to the COVID 19 pandemic, Ministry of Corporate Affairs ('MCA') had relaxed the provisions allowing Companies to hold there Board meeting/General Meeting via. Video conferencing ('VC') and other audio visual means till 31st December, 2020.

However, by virtue of MCA notification dated 30th December, 2020, the said timelines of 31st December, 2020 has further been extended till 30th June, 2021.

GST

1

GST Clarifications and Updates

I. Extension in time limit for anti-profiteering compliances under GST

The time-limit for compliances and action in respect of anti-profiteering measures specified under section 171 of Central Goods and Services Act, 2017, which falls during the period from 20th day of March 2020 to 30th day of March 2021, has been extended upto 31st day of March 2021.

(Notification No. 91/2020 – Central Tax dated 14 December 2020)

II. Provisions of Central GST Act, 2017 ('Act') effective from 1 January 2021

- Earlier the time limit for availing ITC in respect of a debit note was dependent on the invoice pertaining to that debit note. Now the provisions have been amended as per which the time limit for availing ITC in respect of a debit note would depend on the period to which the debit note pertains;
- Provisions relating to cancellation (or suspension) of registration have been extended to registered persons who voluntarily obtained GST registration;
- Penalty provisions in case of specified offences have been extended to a person who retains the benefit of such transaction and at whose instance such transaction is conducted. The penalty sought to be imposed in such cases is an amount equivalent to the tax evaded or input tax credit availed of or passed on;
- Provisions related to punishment for certain offences have been extended to include whoever causes to commit and retain benefits arising out of such an offence. Further, the provisions related to punishment for wrong availment of ITC have been extended to include cases where ITC is availed without any bill or invoice; and
- Earlier in terms of Schedule II (Activities or transactions to be treated as supply of goods or supply of services) certain specified transactions related to Transfer of business assets were treated as supply "whether or not for a consideration". Vide the amendment, the said restriction i.e. "whether or not for a consideration" has been removed.

(Notification No. 92/2020 – Central Tax dated 22 December 2020)

III. Amendment in Central Goods & Services Tax Rules, 2017 ('Rules')

- Subject to date to be notified, at the time of filing of GST registration, biometric-based Aadhaar authentication for registration application under GST has been made applicable if the applicant has opted for authentication of Aadhaar Number, else the applicant would need to verify through biometric information, photograph and other KYC documents (to be notified);
- The time-limit for system based GST registration- The proper officer would approve the grant of registration or issue deficiency within 7 days from date of submission of application instead of earlier mentioned 3 days, in case the applicant has opted to undergo Aadhar Authentication.

  Further, where the applicant does not opt for Aadhaar Authentication or where department feels fit to carry out physical verification the time-limit for grant of registration has been extended to 30 days;
- Rule 21 of the Rules has been amended to provide power to proper officer, to cancel the registration granted to a taxpayer where such taxpayer has availed ITC in violation of Section 16 of the Act, or where the liability declared in FORM GSTR-3B is less than the declared liability in FORM GSTR-1 for one or more tax periods;

- From 1 January 2021, Invoices furnished through Invoice Furnishing Facility or through FORM GSTR-1 by the supplier would be considered for calculation of ITC under rule 36(4). Further, the claim of ITC in respect of invoices not furnished by the corresponding vendors has been restricted to 5% from 10 % of the ITC reported by supplier;

- States that the FORM GSTR-1 would be blocked where a taxpayer fails to furnish FORM GSTR-3B for two subsequent months for the taxpayers filing returns on monthly basis, similarly in case for quarterly filers the FORM GSTR-1 for subsequent quarter would be blocked in case a taxpayer fails to furnish FORM GSTR-3B for preceding quarter; and

- A new Rule 86B has been introduced which will come in effect from 1 January 2021. The rule states that where taxable supplies of a registered person (other than exempt supply and zero-rated supply) in a month exceeds INR 50 lakhs, Electronic Credit Ledger can be used for discharging the output tax liability only up to 99% of such tax liability i.e. 1% tax liability would be required to be paid in cash. The said restriction would not apply in certain cases which are as follows:

    - Taxpayer has paid income-tax exceeding INR 1 lacs in two preceding financial years;

    - Taxpayer has received refund exceeding INR 1 Lacs under section 54 of CGST Act 2017;

    - Taxpayer has used electronic cash ledger to pay liability on outward supplies, which cumulatively makes 1% of the total liability up to the said month;

    - Where a taxpayer is a Government Department, Public Sector Undertaking, local authority or a statutory body.

- E-way bill would be valid for one day Upto distance of 200 KM instead of 100 KM as earlier provided in the rule 138 (10). One day additional would be allowed for every 200 KM instead of 100 KM or part thereof after initial 200 KM.

(Notification No. 94/2020 – Central Tax dated 22 December 2020)

IV. Extension in time-limit for furnishing of Annual Return

The time-limit for furnishing annual return viz. Form GSTR-9, Form GSTR-9B and Form GSTR-9C for the Financial Year 2019-20 has been extended till 28 February 2021.

(Notification No. 95/2020 – Central Tax dated 30 December 2020)

V. Waiver from recording of UIN on the invoices

Central Board of Indirect Taxes and Customs has given waiver from recording UIN on the invoices issued by retailers/suppliers pertaining to the refund claims from April 2020 to March 2021, subject to the condition that the copies of such invoices are attested by the authorized representative of the UIN entity and the same is submitted to the jurisdictional officer.

(Circular No. 144/14/2020 – GST dated 15 December 2020)

2

Advance Rulings & Judgements

I. Karnataka Appellate Authority for Advance Ruling ('AAAR') rules that the service delivered over the internet or an electronic network with minimum human intervention would be classified as OIDAR services

- The Respondent Company offers different types of online-test administrative solutions on behalf of its clients to the test-takers in India. One such test (Type 3 test) is a mixture of Multiple-Choice Questions (MCQ) and essay-based questions. The issue involved is whether the element of human intervention involved in the process of scoring the essay responses in theType-3 test is "minimum human intervention" or not;

- Since there are no guidelines in Indian laws regarding the concept of minimum human intervention in electronically provided services, reference to the European Commission VAT Committee Working Papers is made, wherein it is agreed that for the assessment of the notion of "minimal human intervention", it is the involvement on the side of the supplier which is relevant and not that on the side of the customer;

- AAAR stated that the role of the human scorer is in effect a means to ensure the reliability of the Automated Essay Scoring system (AES). The reliability of the AES is validated by the near agreement to the score given by the human scorer and the candidate who is the service receiver has received a fully digitally provided service;

- AAAR held that the scoring done by the human scorer is to be regarded as being within the realm of minimum human intervention. As such the ingredient of "minimum human intervention" required to classify the service as OIDAR is also satisfied and we set aside the ruling given by the Authority for Advance Ruling.

M/s NCS Pearson Inc

(Ruling No. KAR/AAAR/07/2020-21, Dated 13 November, 2020)

3

Key Customs updates

I. Import and Export of vaccines in relation to COVID-19 through courier

- In order to facilitate import/export of vaccines in relation to COVID-19 through courier, at locations where Express Cargo Clearance System is operational, the Board has issued the Courier Imports and Exports (Electronic Declaration and Processing) Amendment Regulations, 2020 to provide the following:
    - Import/Export of vaccines in relation to COVID-19 has been allowed without any value limitation.
    - Since the vaccines will be imported in durable containers equipped with the requisite temperature monitoring and tracking devices, suitable amendment to sub-regulation (3) of regulation 6 and the declaration in Form H (CSB IV) of the Regulations have been made to provide for the export of the durable container including accessories thereof, imported in relation to COVID-19 vaccines.
    - Furthermore, the clarifications contained in Circular No. 51/2020 - Customs, dated 20 November 2020 would apply for the temporary importation and re-export of the durable containers including accessories thereof imported in relation to the COVID-19 vaccines through Courier.

(Circular No. 56/2020 – Customs dated 30 December 2020)

4

Other IDT Updates

I. Remission of Duties and Taxes on Exported Products (RoDTEP) Scheme to be implemented from 1 January 2021

- Government to extend the benefit of the RoDTEP scheme with effect from 1 January 2021.
- The said scheme would refund to exporters, the embedded Central, State and local duties/taxes that were so far not being rebated/refunded. The refund would be credited in an exporter's ledger account with Customs and used to pay Basic Customs duty on imported goods. The credits can also be transferred to other importers.
- The RoDTEP rates would be notified shortly by the Department of Commerce.
- An exporter desirous of availing the benefit of the RoDTEP scheme shall be required to declare his intention for each export item in the shipping bill or bill of export. The RoDTEP shall be allowed, subject to specified conditions and exclusions.
- The notified rates, irrespective of the date of notification, shall apply with effect from 1 January 2021 to all eligible exports of goods.

(PIB Delhi – Ministry of Finance, posted on 31 December 2020)

Compliance Calendar

Direct Tax

Due Date	Particulars
7th January 2021	Payment of TDS - For the period 1st December 2020 to 31st December 2020
	Payment of TCS - For the period 1st December 2020 to 31st December 2020
	Payment of Equalisation Levy on online advertisement and other specified services, to be discharged by Indian payers, referred to in Section 165 of Finance Act, 2016 - For the period 1st December 2020 to 31st December 2020.
10th January 2021	Due date of filing of Income tax return for Assessment Year ('AY') 2020-21 in case of non-corporate assessees whose accounts are not required to be audited under the Income-tax Act, 1961 or not liable for reporting of international transaction and specified domestic transactions (Extended date vide notification dated 31st December 2020)
15th January 2021	Due date of furnishing of various tax audit reports as prescribed under different sections of the Income-tax Act, 1961 (Extended date vide notification dated 31st December 2020)
	Due date of furnishing of reports in respect of international or specified domestic transactions (Extended date vide notification dated 31st December 2020)
	Due date of furnishing of quarterly TCS statement for the quarter ending on 31st December 2020.
30th January 2021	Payment in respect of tax deducted under section 194-IA in the month of December 2020.
	Payment in respect of tax deducted under section 194-IB in the month of December 2020.
	Payment in respect of tax deducted under section 194-M in the month of December 2020.
15th January 2021	Due date of furnishing of quarterly TDS statement for the quarter ending on 31st December 2020
	Last date for filing declaration under Direct Tax Vivad se Vishwas Act, 2020 (Extended date vide notification dated 31st December 2020)

GST

Compliance Category	Compliance Description	Frequency	Due date	Due Date falling in December 2020
GSTR-1 (Details of outward supplies)	• Registered person having aggregate turnover over INR 1.5 crores	Monthly	11th day of succeeding month	• December - 11 January 2021
	• Registered person having aggregate turnover of upto INR 1.5 crores	Quarterly	13th day of subsequent month following the end of quarter	• October to December - 13 January 2021
Form GSTR - 3B (Monthly return)	• Registered person having turnover more than INR 5 crores	Monthly	20th of next month	• December - 20 January 2021
	• Registered person with aggregate turnover up to INR 5 crore having place of business in Group 1 states and union territories[1]	Monthly	22nd of next month	• December - 22 January 2021
	• Registered person with aggregate turnover up to INR 5 crore having place of business in Group 2 states and union territories[2]	Monthly	24th of next month	• December - 24 January 2021
Form GSTR-6 (Return for input service distributor)	• Return for input service distributor	Monthly	13th of succeeding month	• December - 13 January 2021
Form CMP-08	• Statement-cum-challan for Composition Dealers	Quarterly	18th day of subsequent month following the end of quarter	• October to December - 18 January 2021

[1] Chhattisgarh, Madhya Pradesh, Gujarat, Maharashtra, Karnataka, Goa, Kerala, Tamil Nadu, Telangana, Andhra Pradesh, the Union territories of Daman and Diu and Dadra and Nagar Haveli, Puducherry, Andaman and Nicobar Islands or Lakshadweep

[2] Himachal Pradesh, Punjab, Uttarakhand, Haryana, Rajasthan, Uttar Pradesh, Bihar, Sikkim, Arunachal Pradesh, Nagaland, Manipur, Mizoram, Tripura, Meghalaya, Assam, West Bengal, Jharkhand or Odisha, the Union territories of Jammu and Kashmir, Ladakh, Chandigarh or Delhi

Regulatory

S. No.	Compliance	Due Date
1.	ECB-2 (Monthly Return of ECBs for the month of December)	January 07, 2021
2.	Submission of Annual Return under Prevention of Sexual Harassment at Workplace (POSH) Act 2013	January 31, 2021* (This may vary from State to State)
3.	AOC-4 (Filing of Financial Statement)	30 days from the date of AGM
4.	MGT-7 (Filing of Annual Return)	60 days from the date of AGM

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