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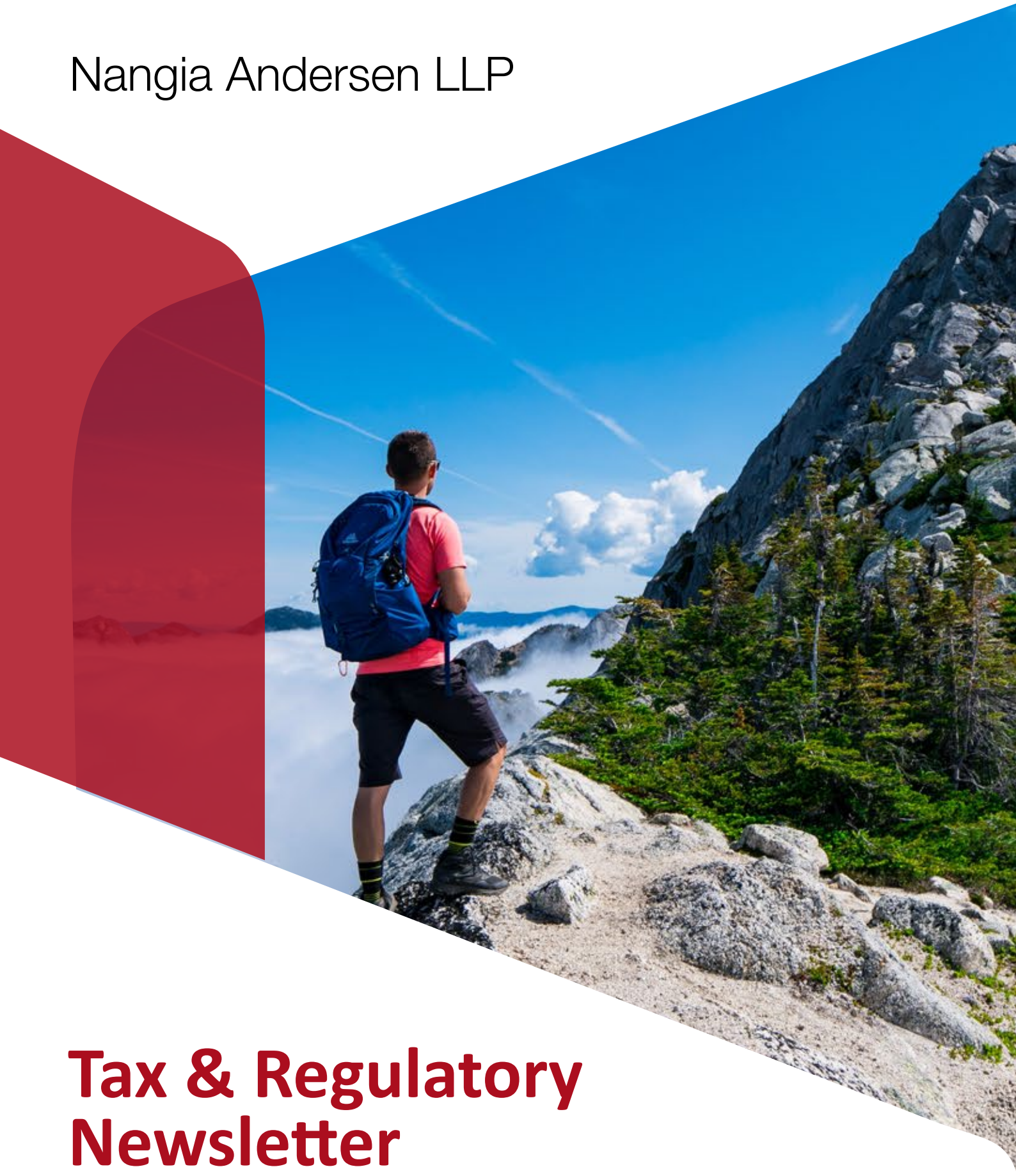

Tax & Regulatory Newsletter

December 2021

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What's Inside?

Direct Tax

Consideration in the nature of "Subscription fees" not taxable as Royalty under the India-USA tax treaty as well as the Indian Income Tax Act

Outcome: Royalty
Category: In favour of the assessee

Background

In case of a US based non-resident assessee "American Chemical Society", the Mumbai Tribunal has issued an edict that subscription fees for access to online databases and online journals is not taxable as Royalty.

Brief Facts and Contentions

- The assessee is a US based entity engaged in promotion and development of knowledge in the field of chemistry. Its Chemical Abstracts Services (CAS) division offers desktop access to databases of scientific content to its customers. Its another division "Publications (PUBS)" is engaged in subscription sales of web-based and printed copies of research journals/ e-journals to its subscribers.

- The assessee earned revenue from providing services of CAS division and PUBS division from Indian customers and did not offer it to tax in India on the grounds that the receipts were not in the nature of Royalty or Fees for Technical services. However, the Assessing Officer (AO) sought to tax the receipts as Royalty.

- Even though the issue was squarely covered in assessee's favour by the Tribunal for AY 2014-15 to AY 2016-17, the DRP upheld the order of the AO since the Tribunal's orders were in further appeal before higher justice forums.

ITAT's Judgement

- For AY 2014-15, in respect of the services of the CAS division, the Tribunal had noted that the customers did not have any rights to exploit the copyright in assessee's software.

- Further, the income from PUBS division was in respect of granting access to e-journals, standardized reports or research articles, which could only be used for personal use. By granting such access, the assessee neither shared its techniques or methodology employed in developing databases nor imparted any information in this regard. Furthermore, the information resided on servers outside India, to which the customers had no rights or access.

- As the customer only acquired a copyrighted article and not a copyright, the consideration received by CAS and PUBS division did not qualify as "Royalty" under section 9(1)(vi) of the Act as well as Article 12(3) of the India-USA treaty.

- As the business model and the revenue stream of the assessee remained the same in the assessment year under consideration, the Tribunal reiterated that the receipts from CAS and PUBS division were not to taxed as Royalty.

Nangia Andersen LLP's Take

The ruling recapitulates the principle that where the customer is given only a non-exclusive and non-transferrable license for access to a database on payment of certain subscription fee, without involving transfer of copyright of database or journals, the amount in question does not constitute "royalty income".

Past Precedents

In case of Swiss entity "IMS AG1[1]", the Mumbai Tribunal held that consideration received for granting non- exclusive access to database and market research reports is not taxable as 'royalty' under the India-Switzerland tax treaty.

[Source- I .T.A. No.1030/Mum/2021]

[1]ITA No.6445/Mum/2016

Where technical knowledge, skill & know how not made available, amount in question not taxable as FTS under India-Singapore DTAA

Issue: FTS/ Disallowance u/s 40
Outcome: In favour of the assessee

Background

The Mumbai Tribunal has held that amount paid for services received for a specific project where no technical knowledge or skill was made available does not qualify as Fees for Technical Services. Accordingly, no disallowance under section 40(a)(i) could be made on account of failure to deduct TDS.

Brief Facts and Contentions

- The assessee "Forum Homes (P.) Ltd" is a company engaged in the business of real estate. It undertook development of a residential project and availed certain services from non-resident entities in Singapore. The charges towards consultancy and architect's fee were remitted without deducting TDS.
- On basis of certain terms contained in the agreements between the parties, the AO held that the non-resident entities made available technical knowledge, experience, skill, know-how or process which enabled the assessee in making design for construction. The AO therefore held that the fee paid to the non-resident entities qualified as FTS under section 9(1)(vii) of the Income-tax Act and Article 12(4) of the DTAA. Accordingly, disallowance was made under section 40(a)(i) for failure to deduct TDS.
- However, CIT(A) held that the fees paid to the non-resident entities did not qualify as FTS under the tax treaty as no technical knowledge, experience, skill, know-how or process was made available. Therefore, he deleted the disallowance made by the AO.

ITAT's Judgement

- On perusal of scope of work and the terms of agreement, the Tribunal noted that services provided by non-resident entities were project specific and could not be used for any other project by the assessee. Further, while providing such services, no technical knowledge, skill or any developed drawing or design was made available to the assessee for independent use in future.
- The Tribunal observed that though the AO and departmental representative observed that the non-resident entities made available technical knowledge, know-how, processes to the assesse in the course of providing services, no substantive material was brought on record to substantiate such claim. Accordingly, CIT(A)'s order was to be upheld.

Nangia Andersen LLP's Take

The Tribunal has reaffirmed the well-established principles regarding taxation of "fees for technical services (FTS) that for an amount to qualify as FTS, technical knowledge or skills of the provider should be imparted to and absorbed by the receiver so that the receiver can deploy similar technology or techniques in the future without depending upon the provider.

Past Precedents

In case of Buro Happold Limited[1], the Mumbai ITAT held that the technical designs/ drawings/ plans supplied by the taxpayer to Indian entity were project-specific and could not be used in any future projects. Therefore, it did not 'make available' technical knowledge, skill, knowhow, etc. to the recipient and hence payments were not taxable as FTS.

[Source- ITA No. 5804/Mum/ 2018]

[1]ITA No. 1296/Mum./2017

Charges for Wide Area Network (WAN) services outside India not taxable as Royalty

Issue: Royalty
Outcome: In favour of the Assessee

Background

In a recent pronouncement, the Bangalore Tribunal has held that the consideration for providing bandwidth facility shall not be taxable as equipment royalty or process royalty.

Brief Facts and Contentions

- The assessee is a tax resident of UK. It entered into an agreement with "Madura Coasts Pvt. Ltd. (MCPL)" to provide Applications Support and Wide Area Network (WAN) Support Services.
- The assessee had a Master Global Framework Agreement (MGFA) with British Telecom Plc. (BT) whereby BT provided WAN services to assessee's subsidiaries and AEs.
- The assessee received a sum towards cost of shrink-wrapped software and another sum as "BT rental charges" from MCLP. The Assessing Officer (AO) sought to tax the receipts as Royalty stating that the consideration was for "right to use" the routers placed in the premises of assessee and MCPL which were very important for MCPL to receive services from the assessee.
- The assessee, however averred that the amount received was "reimbursement of cost" which the assessee paid to BT. The connectivity services were provided by BT by deploying its technology which was not transferred at any point of time. It had no rights over the equipment or the process. The use of router was only for obtaining services from BT. Accordingly, the sum received was neither FTS nor Royalty under the Indo-UK tax treaty. In absence of a PE or a business connection in India, the recoup of charges could also not be taxed as business profits.

ITAT's Judgement

- Notably, in case of Asia Satellite[1], the Delhi High Court held that payment for use of transponder capacity for uplinking /downlinking data would not constitute royalty. This view was endorsed by the Bombay High Court in case of Siemens Aktiongesellschaft[2]. However, the Madras High Court in case of Verizon Communications Singapore Pte. Ltd[3] opined that the consideration for provision of bandwidth/ telecommunications services outside India was for the 'use of or the right to use equipment' and therefore shall be taxable as Royalty.
- As there was no decision of the jurisdictional High Court, i.e. Karnataka High Court, the Tribunal followed the decision of Delhi High Court and Bombay High Court to accord the benefit of interpretation to the assessee and held that the consideration for providing bandwidth facility would not be taxable as equipment royalty or process royalty. Further, the Tribunal did not discuss the taxability of receipts as FTS or business income as the Revenue had not made out a case in this regard. The Tribunal also reiterated that the amounts received towards cost of shrink-wrapped software was not taxable as Royalty as established by the Supreme Court in case of Engineering Analysis Centre of Excellence Pvt. Ltd.

Nangia Andersen LLP's Take

In the instant case, the Tribunal has concurred with Delhi Tribunal's view that installation of equipment to allow users to avail benefits of such equipment or standard facility does not tantamount to granting the right to use that equipment or process so as to be considered as Royalty.

[1]Asia Satellite Telecommunication Co. Ltd. vs. DIT — (197 Taxmann 263)
[2]CIT v. Siemens Aktiongesellschaft [2009] 177 Taxman 8/310 ITR 320 (Bom.)
[3]Verizon Communications Singapore Pte. Ltd v. ITO (International Taxation) [2013] 39 taxmann.com 70

Transfer Pricing

ITAT allows functional, economic and market adjustments to non-AE sales price for computing ALP under CUP

Outcome: In favor of taxpayerr
Category: Transfer pricing ("TP") Adjustment; Selection of Most appropriate method

Facts of the case:

- FDC Ltd. ("The taxpayer") is engaged in the manufacturing of formulation and Active Pharmaceutical Ingredients.
- During the year under consideration, taxpayer had entered into international transactions with its overseas Associate Enterprise ("AE") in the nature of sale of finished goods and initially adopted Cost Plus Method ("CPM") to benchmark the said transaction from arm's length perspective.
- On TPO's request, the taxpayer demonstrated arm's length pricing under CUP method and made eight adjustments to account for difference in terms and conditions between sale to AE in the UK and non-AE, by taking the non-Ae sales as the base.
- During the course of assessment proceedings, the Ld. Transfer pricing officer ("TPO") disallowed 5 adjustments (adjustments on account of competition market, sales return, marketing cost, functional differences and non-variable cost (out of the eight adjustments proposed by taxpayer). Aggrieved by the same, taxpayer appealed before Commissioner of Income Tax (Appeals) ["CIT (A)"].
- CIT (A) allowed 2 adjustments out of 5 namely on Functional Difference adjustment and Marketing Costs adjustment and disallowed other adjustments i.e. Non-Variable Cost, Sales return adjustment and Competition Adjustment which reduced the TP Adjustment from ₹802.26 lacs to ₹151.16 lacs.
- Aggrieved by the same, the revenue as well as taxpayer filed an appeal before the Income Tax Appellate Tribunal ("ITAT"/ "the tribunal").

ITAT's Ruling:

The ITAT discussed every adjustment in detail and made the following observations:

- **Functional Difference Adjustment:** ITAT noted that in case of sales to Non-AE, product license maintenance cost and lab analysis were borne by the taxpayer whereas in the case of sales to AE, the said cost is borne by the AE. Hence, ITAT holds CIT(A) decision of allowing the adjustment.
- **Marketing Cost Adjustment:** ITAT observed that marketing costs vary with geographical location and impact the selling price, hence allowed the adjustment.
- **Non-Variable Cost Adjustment:** ITAT observed that since the pack size of products is not similar and while computing ALP such hypothetical selling price and cost have been considered in proportion to pack size, and therefore ITAT held that adjustment arising out of hypothetical non-variable cost based in the same proportion should be computed.
- **Sales Return Adjustment:** ITAT highlighted the subtle differentiation between the terms of the sales returns wherein for AE sales claims, returns were borne by the AE and for non-AE sales, the same were borne by the taxpayer, accordingly ITAT allowed the said adjustment
- **Competition variability adjustment:** ITAT also allowed this adjustment on the basis of taxpayer's submission of detailed chart and scientifically quantification of the competition effect between two geographical locations qua market conditions and government regulations.

Conclusively, ITAT allowed all 5 adjustments objected by the lower authorities.

Nangia Andersen LLP's Take

The instant ruling supports the provisions of Rule -10B which provides that appropriate adjustments are allowed while applying CUP method.

The instant ruling clearly emphasizes on the fact that appropriate adjustments are justifiable, provided that the taxpayer submits appropriate reasons aligned with the prevalent situation of the case for providing such adjustments. In view of the same, it is recommended that the taxpayers should maintain robust documentary evidence in order to suffice the position taken by the taxpayer from TP perspective.

Source: FDC Limited [TS-573-ITAT-2021(Mum)-TP]

Regulatory

I. Financial Sector Updates

A. Discussion Paper on Digital Banks

Reserve Bank of India ('RBI') in November 2021 has come up with a proposal for licensing and regulating digital banks in the form of a discussion paper seeking public comments. Comments on discussion paper may be provided till 31st December 2021.

Few important highlights under the discussion paper are as follows:

- Digital Banks ('DBs') have been defined as the entities which will issue deposits, make loans and offer the full suite of services under the Banking Regulation Act, 1949. Further, as the name suggests, DBs will principally rely on the internet and other proximate channels to offer their services and not physical branches.

- The paper also recommends a two-stage approach - a digital business bank license to begin with, followed by a Digital (Universal) Bank license.

- Features / Conditions of Digital Business bank License are as follows:

  - Minimum Paid-up Capital for a restricted Digital Business bank operating in a regulatory sandbox may be proportionate to its status as restricted.

  - The license may require one or more controlling persons of the applicant entity to have an established track record in adjacent industries such as e-commerce, payments, technology

  - DBs should have access to all the key infrastructure enablers in the Indian financial ecosystem, as traditional banks.

  - Digital Business banks will be required to fully comply with any regulations touching upon bank conduct that RBI may issue from time to time.

  - Subject to asset and deposit limits and other restrictions, a Digital Business bank should be able to offer standard banking services in the restricted phase.

B. Working Group Report on Digital Lending

RBI on 18 November 2021 has issued a report of the working group on digital lending including lending through online platform and mobile apps.

According to the Report, Digital lending has been defined as a remote and automated lending process, majorly by use of seamless digital technologies in customer acquisition, credit assessment, loan approval, disbursement, recovery, and associated customer service.

Some of the key recommendations of the Working Group are as follows:

- A nodal agency would be set up which will ' primarily verify the technological credentials of Digital Lending Application ('DLAs') of the balance sheet lenders and Lending Service Provider ('LSPs') operating in the digital lending ecosystem.

- Balance sheet lending through DLAs should be restricted to entities regulated and authorized by RBI or entities registered under any other law for specifically undertaking lending business

- An SRO should be constituted covering the participants in the digital lending ecosystem.

- All loan servicing, repayments, etc. should be executed directly in a bank account of the balance sheet lender and disbursements should always be made into the bank account of the borrower.

- 'Banning of Unregulated Lending Activities Act' may be introduced by the Government to prevent illegal lending activities.

- Compliance with the prescribed baseline technology standards should be a pre-condition to offer digital lending

- Each DLA should have publicly available policies regarding data storage, its usage and privacy and Data should be stored in servers located in India.

II. Updates under Securities and Exchange Board of India ('SEBI')

A. Write-off of Debt Securities held by Foreign Portfolio Investors ('FPIs')

SEBI *vide.* its Circular No SEBI/ HO/ FPI&C/ P/ CIR/ 2021/ 656, dated 08 November 2021, has decided to permit FPIs to write off all debt securities in their beneficiary account which they are unable to sell for any reason.

Earlier in September 2021, SEBI had permitted write off of shares in the beneficiary account which they were unable to sell for any reason.

The aforesaid amendment shall be applicable only to such FPIs who wish to surrender their registration.

B. Amendment to listing Obligations and Disclosure Requirements

SEBI *vide*. a Notification No. SEBI/L AD-N RO/GN/2021/55 dated 09 November 2021 has issued SEBI (Listing Obligations And Disclosure Requirements) (Sixth Amendment) Regulations, 2021 which shall come into effect from April 1 ,2022.

Some of the important highlights under this amendment are as follows:

- According to the amendment, any person or entity forming a part of the promoter or promoter group or any person or any entity, holding equity shares of 20% or more (10% w.e.f. 1st April, 2023) in the listed entity either directly or on a beneficial interest basis, at any time, during the immediate preceding financial year shall be deemed to be a related party.
- Definition of Related Party Transactions has been amended. According to the amendment, **Related Party Transaction means a transaction involving a transfer of resources, services or obligations between:**

  i. a listed entity or any of its subsidiaries on one hand and a related party of the listed entity or any of its subsidiaries on the other hand

  ii. a listed entity or any of its subsidiaries on one hand, and any other person or entity on the other hand, the purpose and effect of which is to benefit a related party of the listed entity or any of its subsidiaries

  regardless of whether a price is charged and a transaction with a related party shall be construed to include a single transaction or a group of transaction in a contract.

  Though there are certain exceptions to the above definition, it has increased the ambit of a Related Party Transactions manyfolds.

- A transaction with a related party shall be considered material **if it exceeds ₹1000 crore or 10% of the annual consolidated turnover of the listed entity** as per the last audited financial statements of the listed entity, whichever is lower. Earlier, it could be considered material if it exceeded 10% of the annual consolidated turnover.

- Further, It has been clarified that even the subsequent material modifications in a related party transaction shall require prior approval of the audit committee of the listed entity.

C. Disclosure Obligations in relation to Related Party Transactions

SEBI *vide.* circular no. SEBI/HO/CFD/CMD1/-CIR/P/2021/662 has prescribed disclosure obligations of listed entities in relation to Related Party Transactions.

The disclosure requirements have been divided into two parts viz. Information to be reviewed **by the Audit Committee** and Information to be **provided to shareholders** for consideration of RPTs.

Further, the format for reporting of RPTs have been specified and the listed entity shall make disclosure every 6 months in the specified format.

III. Updates Under FSSAI

Legal Metrology (Packaged Commodities) Amendment Rules, 2021

Ministry Of Consumer Affairs, Department of Consumer Affairs on 02 November 2021 has issued the Legal Metrology (Packaged Commodities) Amendment Rules, 2021 ('Rules').

The amendments proposed under the said Rules are as follows:

- When one or more packages intended for retail sale are grouped together for being sold as a retail package on promotional offer, every package of the group shall comply with provisions of Rule 6 (Declarations to be made on every package).

- The month and year in which the commodity is manufactured has to be specified on the commodity. Earlier the date of manufacturing or pre-packed or imported could be specified.

- The retail sale price of the package has to be only specified in the Indian currency (INR)

- The unit sale price shall be declared in the following manner:

  - Rs./g for pre-packaged commodities with net quantity of commodity less than one kilogram;
  - Rs./kg for pre-packaged commodities with net quantity of commodity more or equal to one kilogram;
  - Rs./cm for pre-packaged commodities with net length of the commodity less than one meter;
  - Rs./meter for pre-packaged commodities with net length of the commodity more or equal to one meter;
  - Rs./number;
  - Rs./ml for pre-packaged commodities with net volume of the commodity less than one litre;
  - Rs./litre for pre-packaged commodities with net volume of the commodity more or equal to one litre.

- For items sold by number, the number or unit or piece or pair or set or such other word which represents the quantity in the package shall be mentioned. Earlier, symbol N or U could be specified.

The aforesaid amendments shall come into effect from 01st April 2022.

Compliance Calendar

Direct Tax

Due Date	Particulars
7th December 2021	Due date for payment of TDS and TCS for the period 1st November 2021 to 30th November 2021.
	Due date for payment of Equalisation Levy on online advertisement and other specified services, referred to in Section 165 of Finance Act, 2016 for the month of November, 2021.
15th December 2021	Due date for payment of third Instalment of advance tax for FY 2021-22
	Due date for issuance of TDS Certificate for tax deducted under section 194-IA in the month of October, 2021
	Due date for issuance of TDS Certificate for tax deducted under section 194-IB in the month of October, 2021
	Due date for issuance of TDS Certificate for tax deducted under section 194M in the month of October, 2021
30th December 2021	Due date for furnishing of challan-cum-statement in respect of tax deducted under section 194-IA in the month of November, 2021
	Due date for furnishing of challan-cum-statement in respect of tax deducted under section 194-IB in the month of November, 2021
	Due date for furnishing of challan-cum-statement in respect of tax deducted under section 194M in the month of November, 2021
31st December 2021	Due date for filing of Income Tax Return for FY 2020-21 in case of all Assessee **other than** following: - 1. Corporate Assessee; 2. Assessee whose books of account are liable for audit; 3. Partner of a firm whose books of account are liable for audit; 4. Assessee liable for furnishing report under section 92E of the Act.
	Due date for furnishing Equalisation levy statement in Form No. 1 for the FY 2020-21

Regulatory

Segment	Particulars	Due Dates
Monthly ECB Return	ECB-2 (Monthly Return of ECBs for the month of October)	07 December 2021
Filing of Financial Statements	Form AOC-4	31 December 2021
Filing Annual Return	Form MGT-7	31 December 2021
Report for ODI	Annual Performance Report	31 December 2021
Annual accounts by foreign company	Form FC-3	31 December 2021
Statement of Account & Solvency by LLP	LLP Form 8	30 December 2021

NOIDA
(Delhi NCR - Corporate Office)
A-109, Sector - 136,
Noida - 201304
T: +91 120 5123000

DELHI
(Registered Office)
B-27, Soami Nagar,
New Delhi - 110017
T: +91 0120 5123000

GURUGRAM
812-814, Tower B, Emaar Digital Greens, Sector-61, Gurugram, Haryana - 122102
T: +91 0124 430 1551

MUMBAI
11th Floor, B Wing, Peninsula Business Park, Ganpatrao Kadam Marg, Lower Parel, Mumbai - 400013, India
T: +91 22 61737000

CHENNAI
Prestige Palladium Bayan,
Level 5, 129-140, Greams Road,
Thousand Lights, Chennai - 600006
T: +91 44 46549201

BENGALURU
Prestige Obelisk, Level 4,
No 3 Kasturba Road,
Bengaluru – 560 001, Karnataka, India
T: +91 80 2228 0999

PUNE
3rd Floor, Park Plaza, CTS 1085,
Ganeshkhind Road, Next to Pune Central Mall, Shivajinagar,
Pune - 411005

DEHRADUN
1st Floor, "IDA" 46 E.C. Road,
Dehradun - 248001, Uttarakhand
T: +91 135 271 6300

www.nangia-andersen.com | query@nangia-andersen.com

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