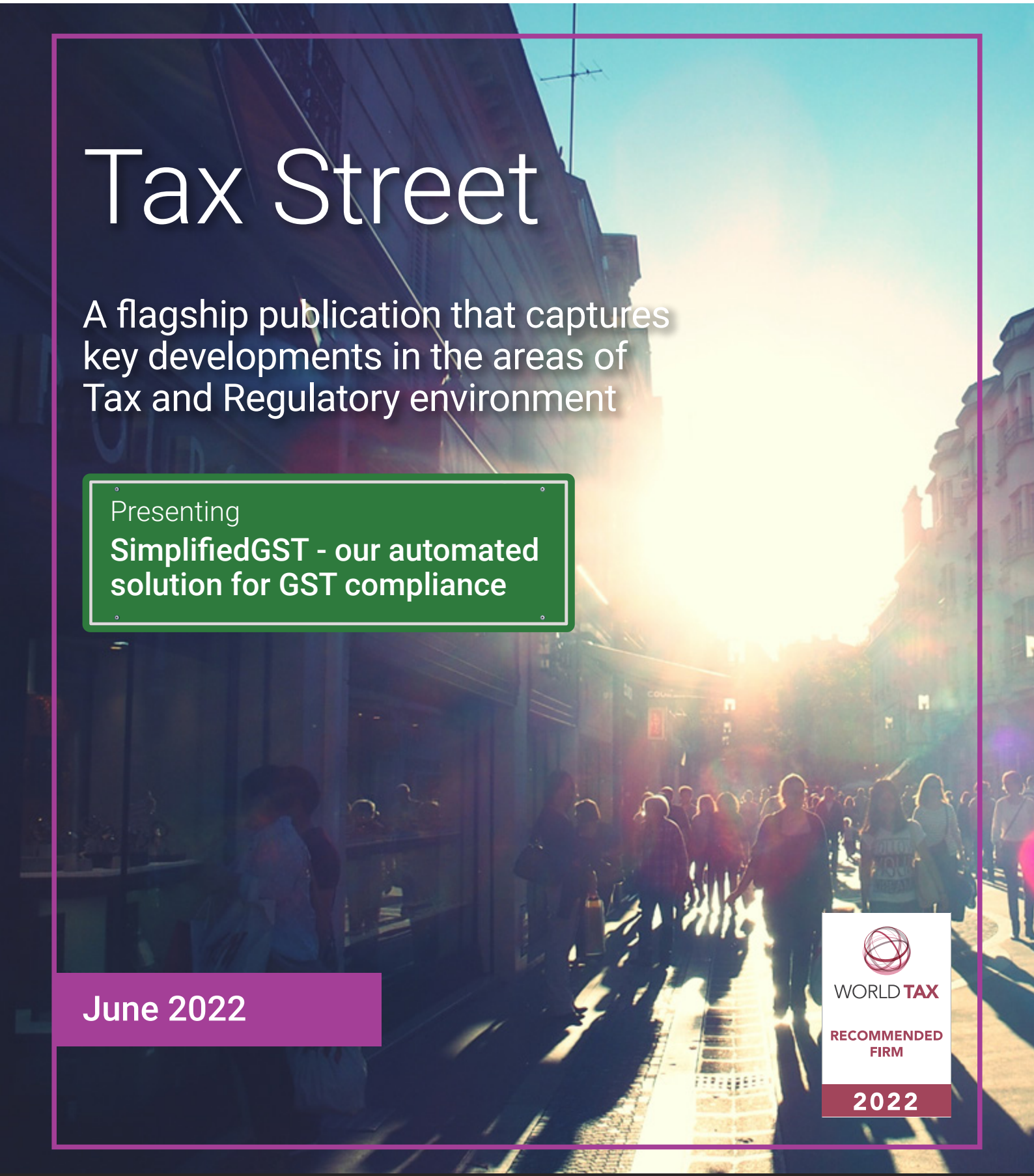

Tax Street

A flagship publication that captures key developments in the areas of Tax and Regulatory environment

Presenting

SimplifiedGST - our automated solution for GST compliance

June 2022

WORLD TAX

RECOMMENDED FIRM

2022

Introduction

Tax Street

We are pleased to present the latest edition of Tax Street – our newsletter that covers all the key developments and updates in the realm of taxation in India and across the globe for the month of June 2022.

- The **'Focus Point'** covers an overview of the Most Favoured Nation Clause from India's perspective.
- Under the **'From the Judiciary'** section, we provide in brief, the key rulings on important cases, and our take on the same.
- Our **'Tax Talk'** provides key updates on the important tax-related news from India and across the globe.
- Under **'Compliance Calendar'**, we list down the important due dates with regard to direct tax, transfer pricing and indirect tax in the month.

We hope you find our newsletter useful and we look forward to your feedback.
You can write to us at **taxstreet@nexdigm.com**. We would be happy to hear your thoughts on what more can we include in our newsletter and incorporate your feedback in our future editions.

Warm regards,
The Nexdigm Team

Focus Point

'Most Favoured Nation' Clause – Insight from India's perspective

The Most Favoured Nation's (MFN) origin can be traced back to the international trade agreements of the World Trade Organization (WTO). Under WTO agreements, countries cannot discriminate between their trading partners. Likewise, in the context of tax treaties, the MFN clause is typically placed in the 'protocols' to tax treaties to ensure that residents of a particular country should not be treated less favorably in comparison to residents of other countries or a group of other countries. By virtue of the MFN clause in several Indian tax treaties, the tax rate or the scope/coverage of tax is restricted to rates/scope present in other beneficial tax treaties.

India's tax treaties with some Organisation for Economic Co-operation and Development (OECD) member States such as the Netherlands, France, the Swiss Confederation, Sweden, Spain, and Hungry contain MFN clauses of varying scope in the protocols to the concerning treaties. Even certain non-OECD States, such as Saudi Arabia and the Philippines, contain the MFN clause. The applicability of the MFN clause in Indian tax treaties has been subject to litigation.

Till the recent past, the application of the protocol to tax treaties (and therefore, consequent application of MFN clause) was generally considered automatic and was not dependent upon any further action by the respective governments. Furthermore, an exception to this appears in India's tax treaties with the Philippines and Switzerland, where a specific enabling action is required from the respective governments to give effect to the MFN clause.

In 2014, the Authority for Advance Ruling(AAR) in the case of Steria (India)[1] Ltd, construed the protocol to the India-France tax treaty in a restricted manner, suggesting that the protocol can be used for interpreting provisions of the tax treaty but not for importing words, phrases or clauses from other tax treaties that are not already present in the base tax treaty. However, within a short span of the pronouncement of the ruling by AAR, another ruling was pronounced by the **Mumbai Tribunal in case of IATA BSP India**[2],which upheld the applicability of the MFN clause present in the protocol to India-France tax treaty, restoring the time-tested principles for interpretation of a tax treaty. Furthermore, the **Delhi High Court in the case of Steria (India)**[3] also held that the protocol is an integral part of tax treaty and it will have equal effect as that of articles contained in the tax treaty.

Furthermore, in a similar context, last year, the **Delhi High Court, in the case of Concentrix Services Netherlands BV**[3], affirmed that the protocol to the India-Netherlands tax treaty forms an integral part of the tax treaty and no separate notification was required to apply the MFN clause in the protocol. However, it is pertinent to note that this controversy gained sparked mainly because Slovenia, Lithuania, and Columbia were not OECD member countries when the Indo-Netherlands tax treaty was executed. These countries became members of the OECD at a later date. Furthermore, all these OECD member countries providing a lower rate of 5% on dividends were not a part of the OECD at the time when India signed a tax treaty with them. Slovenia became a member of the OECD on 21 July 2010, Lithuania became a member of the OECD on 5 July 2018, and Colombia became an OECD member as recently as 28 April 2020 only.

Accordingly, there was uncertainty about whether the beneficial treatment can be borrowed from a tax treaty with such a country that was not an OECD member at the time when the bilateral treaty was negotiated and instead became an OECD member later. In this regard, a unilateral decree/

1. Steria India [TS-5588-HC-2016(DELHI)-O]
2. IATA BSP India [2014] 46 taxmann.com 150 (Mum. – Trib.)
3. Concentrix Services Netherlands B.V. ITO (W.P.(C) 9051/2020)

bulletin issued by the Netherlands and France stated that the tax rate on dividends under the respective tax treaty with India stood modified under the MFN clause after India entered into a tax treaty with Slovenia. However, by applying the principle of parity and the principle of common interpretation with reference to a decree issued by the Dutch authorities, the High Court has granted the benefit of a lower withholding tax rate of 5% to dividends received by a Dutch tax resident from an Indian subsidiary company.

The Central Board of Direct Taxes (CBDT) of India has recently released a **Circular**[4] dated 3 February 2022, wherein it has clarified its stance regarding the interpretation of the MFN clause. The Circular provides that benefit of a lower rate and restricted scope under the MFN clause will be extended only when all the below conditions are satisfied cumulatively:

- The unilateral decree of a treaty partner does not represent a shared understanding of the applicability of the MFN clause.
- The third State (the country whose lower restricted tax rate is to be considered) has to be an OECD member at the time of signing its treaty with India.
- The benefit shall only be available after the date of entry in force with the third State, not from when it became a member of OECD.
- India issues a separate notification under the Income Tax Laws for importing the favorable benefits of the third State treaty into the original treaty.

Accordingly, only if all the conditions mentioned above are satisfied, then the lower rate or restricted scope in the tax treaty with the third State is imported into the tax treaty with an OECD State having MFN clause from the date as per the MFN clause in the tax treaty, after following the due procedure under the IDTL. Typically, a circular issued by CBDT is binding on the tax officer and not on the taxpayer or Tribunal or other Appellate Authorities. It is pertinent to note that the tax authorities, specifically at the lower level, would place reliance on the said circular and deny the tax treaty benefit by importing the MFN clause.

It is imperative to note that even after the circular, the **Pune Tribunal, in the case of GRI Renewable Industries S.L.**[5] held that no separate notification by India is required to secure the benefit of the MFN clause under the India-Spain income tax treaty. The Tribunal stated that the circular overlooks the plain language of the IDTL as seen in contrast to the language of the protocol, which treats the MFN clause as an integral part of the tax treaty. Furthermore, the Circular issued by the CBDT is binding on the tax authority, and also, the Circular cannot be applied retrospectively as it is disadvantageous to the taxpayer for taking benefit conferred by the treaty. Similarly, the **Delhi High Court, in the case of Saint Gobain India Ltd**[6] has granted interim relief to the taxpayer by allowing the French shareholder to receive dividends after the deduction of tax at 10% under protest. The Delhi High Court specified that half of the tax withheld shall be subject to the judgment of the Court.

Furthermore, it is pertinent to note that the Circular mentions that in case a taxpayer has obtained a favorable ruling from any court, the Circular should not affect the implementation of the court order in such a case. However, there is not much clarity on whether the Circular only refers to past decisions or future decisions. It is expected that the Supreme Court of India (Apex Court), would mostly address this controversy, providing much-awaited certainty on the same.

4. CBDT Circular No. 3/2022, dated 3 February 2022
5. GRI Renewable Industries S.L [TS-79-ITAT-2022(PUN)]
6. Saint Gobain India Ltd W.P.(C) 9316/2022 & CM APPLs.27903-27904/2022

From the Judiciary

Direct Tax

Whether payment for benchmarking services can qualify as Fees for Technical Services (FTS)?

M/s Reliance Industries Ltd. vs ACIT
ITA No.5688/Mum/2019

Facts

The taxpayer is an Indian company engaged in the business of oil exploration, refining crude oil, manufacturing and trading of petrochemicals. During the year under consideration, the taxpayer entered into an agreement with a company based in the US to receive benchmarking services. The taxpayer filed an application with Indian tax authorities seeking authorization for making the payment for said services with NIL withholding taxes. The taxpayer adopted a view that such income is non-taxable business income under the India-USA Double Tax Avoidance Agreement (DTAA) in the absence of its Permanent Establishment (PE) in India.

The Assessing Officer (AO) concluded that payments made by the taxpayer to the US entity should be considered as FTS, and hence taxpayer was liable for withholding tax on the said amount.

On appeal by the taxpayer, the Commissioner of Income-tax (Appeals) [CIT(A)] held that the taxpayer was not liable to deduct tax at source on the payments made as it did not qualify as FTS. Aggrieved by the order, the Revenue had raised the aforesaid grounds before the Mumbai Tribunal.

Held

After considering the data on record, the Bangalore Tribunal observed that for those payments to fall under FTS as per India-USA DTAA, the service providers should have made the technical knowledge, experience, skill, and know-how available, etc. to the taxpayer. The Tribunal specified that benchmarking services only enable the taxpayer to take further action to improve its qualitative capacity. However, such services did not provide any know-how or technical knowledge. The Tribunal also noted that the US vendor was not a domain expert in the area where the taxpayer operated; hence, the make available conditions of Article 12(4)(b) under India-USA DTAA are not satisfied.

Thus the Tribunal stated that these payments constitute business income and in the absence of a PE of the vendor in India, these payments are not chargeable to tax in India.

Our Comments

It has always been a contentious issue whether a particular service is covered under FTS. The Mumbai Tribunal has re-iterated that the "make available test" is a pre-requisite for qualification of a transaction to be FTS where the definition of FTS is restrictive.

Whether reimbursement of bandwidth charges services can be Royalty or Fees for Technical Services (FTS)?

M/s Madura coats Pvt Ltd. vs DCIT
IT(IT)A Nos. 1344 & 1345/ Bang/2019

Facts

The taxpayer is an Indian Company engaged in the business of manufacturing and sewing threads and other goods. During the year under consideration, the taxpayer paid bandwidth charges to a company based in the UK. The taxpayer made such payments without deducting any withholding taxes on the footing that the UK company did not have a PE in India and the payment was neither in the nature of Royalty nor FTS.

The AO was of the view that these payments were 'use' or 'right to use' towards dedicated bandwidth, the process, and equipment associated with the network and thus qualified as Royalty both under Indian domestic tax law (IDTL) and under India-UK DTAA. Hence taxpayer was liable for withholding tax on the said payment. Furthermore, the AO held that income from bandwidth services was in the nature of FTS under IDTL as well as under India-UK DTAA.

The CIT(A) confirmed the AO's order. Aggrieved by the order, the taxpayer filed an appeal before the Bangalore Tribunal.

Held

The Tribunal emphasized the fact that there was neither transfer of any intellectual property nor any exclusive right has been granted to the taxpayer for the use of intellectual property in the network. The Tribunal also observed that the taxpayer does not have any ownership, control, possession or rights in respect of any process in the network owned by the UK company or equipment associated with it. Thus, the Tribunal stated that said payment does not constitute Royalty.

On the issue of classification of reimbursement of bandwidth charges as FTS, the Tribunal held that no technical knowledge, know-how, skill, etc., is made available to the taxpayer enabling the taxpayer to use it independently. The Tribunal stated that since the make available condition of Article 13(4)(c) under India-UK DTAA is not satisfied, the amount received will not be treated as FTS.

Our Comments

The Tribunal has accepted that bandwidth fees cannot be considered as payments for the 'use of the process' or 'use of equipment' and thus does not qualify as Royalty under DTAA.

Transfer Pricing

Rate of interest on loan transactions cannot be equated with delayed outstanding receipts

Zeta Interactive Systems (India) Pvt Ltd[7]

Facts

The taxpayer is engaged in rendering software development and information technology-enabled services to its Associated Enterprise (AE) and benchmarked the international transactions using the external Transactional Net Margin Method (TNMM). The taxpayer did not report the interest on outstanding receivables as an international transaction.

In addition to the issue relating to the choice of comparables for the software development segment, the Transfer Pricing Officer (TPO) made an upward adjustment by levying interest at 12% on outstanding receivables and held that details regarding raising of invoices and subsequent receipts along with the transfer pricing study (for the said arrangement) were not filed by the taxpayer even pursuant to the show cause notice issued by the TPO.

The CIT(A) observed that 60% of the total receivables were from the AE and considered 8% as a reasonable rate of interest on outstanding receivables as against 12% computed by the TPO.

Held

The transactions of the taxpayer are required to be examined from the perspective of a prudent business man and analyzed whether the taxpayer would extend similar benefits to unrelated parties. Citing reference to Section 92B of the Act[8], the ITAT held that outstanding receivables are is required to be benchmarked to ensure that there should not be any shifting of profit from taxpayer to the AE.

Delay in receiving its dues, the taxpayer has faced economic consequences as it is required to bear the cost of trade receivables without any carrying cost. In case of outstanding receivables for a longer period, the taxpayer would be required to deploy more resources either in the form of debt/equity to meet the cash flow/working capital requirements.

The Income-tax Appellate Tribunal (ITAT) outlined that adopting LIBOR+200 points would defeat the purpose of benchmarking trade receivables and tantamount to shifting the profits. The ITAT further held that the rate of interest on loan transaction (LIBOR + points) could not be equated with delayed receipt of the outstanding amount by the taxpayer from its AE as both stand on different premises having different purposes and natures.

The ITAT concluded that in a strict sense, the application of 8% interest rate would be contrary to the principles of TP analysis as the interest rate is ideally required to be backed up by internal or external comparables and applying Comparable Uncontrolled Price (CUP) method to fix the rate of interest. However, to give a quietus to the issue, the rate of interest was reduced to 6% on the outstanding receivables at the year-end.

Our Comments

In the above ruling, the ITAT has emphasized that overdue outstanding receivables and loan arrangement stands on different premises having different purpose and nature. The mechanism used to benchmark the arrangement relating to a loan transaction may not hold relevance for benchmarking overdue outstanding receivables. Furthermore, while concluding the interest rate at 6%, the ITAT itself applied an Adhoc rate instead of following TP principles and a scientific approach.

7. ITA No.1812/Hyd/2017

8. Income Tax Act, 1961

Reference to TPO to be made within the course of normal assessment under Section 153

Virtusa Consulting Services Private Limited[9]

The taxpayer is engaged in the business of software development services globally. For AY 2006-07, the AO sought permission from the CIT to make reference to the TPO, which was approved and granted on 18 November 2008. Thereafter, notice under Section 92CA of the Act, the TPO notice to the taxpayer on 17 February 2009 (i.e., post expiry of a time limit of 21 months, i.e., 31 December 2008 from the end of the AY – time limit for regular assessment, without TP reference).

The taxpayer participated in the proceedings before the TPO and no objection was raised regarding the limitation during TP assessment proceedings. It was only before the Dispute Resolution Panel (DRP) that the taxpayer raised the objection regarding the limitation for the first time.

The time limit specified for completing regular assessments under the first proviso to erstwhile S. 153 of Act altered the original time limit from 24 months to 21 months vide amendment with effect from 1 June 2006[10]. The second proviso[11] extended the time limit for assessments for transfer pricing cases from 24 months to 33 months.[12]

The taxpayer contended that the non-obstante clause under the 2nd proviso to Section 153(1) of the Act extending the period from 21 months to 33 months is circumscribed by two jurisdictional pre-conditions, and they need to be satisfied by the respondents, namely, (i) reference under Section 92CA (1) is made by the AO to the TPO and (ii) reference must be made during the course of assessment proceedings.

In the present case, the limitation to finalizing the assessment expired on 31 December 2008 and the reference made on 17 February 2009 is legally not sustainable.

The DRP dismissed the objection of the taxpayer with regard to the limitation. Challenging the order passed, the taxpayer filed a writ petition before Madras High Court, invoking Article 226 of the Constitution of India.

The single-judge bench of the Madras High dismissed the taxpayer's writ.

Aggrieved, the taxpayer filed an intra-court appeal[13] before the division bench. The bench held that -

- Though the taxpayer participated in draft scrutiny proceedings, a legal plea can be raised at any stage and there cannot be any waiver of a statutory right.
- The language used in 2nd proviso to Section 153 is "reference" and not "approval". "Reference" is used in the context of reference to TPO, and "approval" is from the CIT. The extended time limit for TP cases under Section 153 comes into operation only on a "Reference to TPO" and not on "concurrence by the CIT."
- When one proviso provides a time limit, and when another proviso extends such time under certain circumstances, it cannot be held that both the provisos are independent. Even if there is any conflict between the two provisions, they must be read harmoniously to make both provisions workable. Accordingly, Section 153 and the first two provisos lay down that the time limit to pass the original period of assessment is 21 months, and when a reference to TPO is made during the course of such proceedings, the time limit would be 33 months.
- If the TPO reference is bad, then as a sequitur, all further proceedings in furtherance of the same are also bad. In the present case, because of a reference after the permissible period, the department has missed the timeline at every stage.
- The period of limitation of 33 months provided under Section 153 would apply to the final assessment order after the directions from the DRP and not the draft assessment order. The bench thereby held that even the directions of the DRP (issued on 24 September 2010) were beyond the permissible limit.

Our Comments

Section 153 limitation prescribes the time limit for passing assessment orders under different scenarios. It is pertinent to note that Section 153 does not explicitly prescribe the time limit for making a reference to TPO. However, unless a reference to the TPO is not made within the course of normal assessment, i.e., expiry of 21 months from the end of the relevant assessment year, the extended time limit of 12 months would fail to be attracted for TP assessments.

The single-judge bench ruling has also harped on the relevance of bringing out the plea of limitations during the proceedings with the lower authorities though the division bench has held that the legal plea can be raised at any stage and there cannot be any waiver of a statutory right.

9. The High Court of Judicature at Madras; Writ Appeal No. 1903 of 2021
10. In Finance Act, 2006
11. Inserted by Finance Act 2007
12. S. 153 was repealed and substituted with effect from 01.06.2016. Under the present S. 153(1) it is clearly mentioned that the period of assessment is 21 months and under S. 153(4), it is clearly mentioned that in case of reference under S. 92CA (1) i.e. transfer pricing provisions apply, the period of assessment would be extended by 12 months.
13. Intra-court appeal means internal or same court appeal but in front of different bench.

Indirect Tax

Whether transfer of excess Input Tax Credit (ITC) from one unit to an ISD unit, by means of issuing tax invoice for outward supply of services, is valid in the eyes of the law?

JSW Steel Ltd. vs. Union of India & Others [2022 (5) TMI 1238 – Odisha High Court]

Facts

- JSW Steel Ltd. was awarded the lease for undertaking mining operations for iron ore blocks in the State of Odisha.
- To undertake the mining process, the company obtained GST registration in the State of Odisha and paid GST under the Reverse Charge Mechanism (RCM) on the bid premium, Royalty, etc., vis-à-vis the licensing services for the right to use minerals, including exploration and evaluation in respect of four mines located inside the State.
- The iron ore extracted from the mining blocks would either be supplied by JSW Steel Ltd (Odisha) to JSW Steel plants by way of stock transfer or to the extent permissible, supplied to third parties.
- Having utilized a portion of the tax paid under RCM to discharge output GST on aforesaid supplies, JSW Steel Ltd (Odisha) raised tax invoices in favor of JSW Steel Ltd.'s HO in Mumbai, which is registered as Input Service Distributor (ISD), towards the supply of facilitation services.
- However, the GST authorities objected to such a modality of adjusting unutilized ITC on the premise that such a device to facilitate units located in other States to claim ITC arising in the State of Odisha was contrary to the statutory mandate.
- Having not been allotted an ISD registration with the State Code of Odisha, the transactions in question were adjudicated as sham by invoking the provisions of Section 74 of the OGST / CGST Act, 2017.
- Hence, the company filed a writ petition before the Odisha High Court seeking a prohibition on the recovery of demand.

Observation

- The Court observed that there was no specific clarity regarding the nature of the support service provided by JSW Steel Ltd (Odisha) to ISD in Mumbai, much less any common services which could be utilized by other units located in other parts of the country.
- It emerges that JSW Steel Ltd (Odisha), has utilized ISD as a wrongful conduit and facilitated the utilization of ITC by other units of JSW Steel Ltd., which in this manner have availed ITC twice, i.e., once on the strength of the purchase invoices of supply of iron ore and the other on the strength of the tax invoices for alleged services, issued by ISD.
- The argument of the company that it is the ISD that has been awarded the contract and, therefore, whatever tax has been deposited in the State of Odisha is actually paid on behalf of the ISD in Maharashtra is not supported by documentary evidence, nor has the statutory backing.
- As per the definition of "Input Service Distributor" under Section 2(61) of the CGST Act, it is necessary that the ISD as an office receives tax invoices towards inward supply. Since no such supply has been made by JSW Steel Ltd. (Odisha) to JSW Steel Ltd. of Maharashtra, no prima facie case is made by the petitioner-company.
- Thus, the transactions in question prima facie amount to siphoning of tax amounts and, therefore, apparently warrant invocation of proceeding under Section 74 of the CGST Act.
- As regards the challenge to the jurisdiction of GST authorities in the State of Odisha, the Court has ordered to file counter-affidavits and objections while listing the matter for hearing in August 2022.

Our Comments

This order could result in similar investigations/scrutiny being initiated with regards to cross State adjustments as compared to ISD against similarly placed taxpayers who have obtained GST registration in other States in adherence to the GST provisions, along with ISD registrations.

Wherever applicable, companies will need to accordingly evaluate if the transfer vide the ISD registration is appropriate.

Whether the appellant is liable to service tax on the penalty (liquidated damages) collected from their contractor?

M.P. Audyogik Kendra Vikas Nigam (Indore) Limited vs. Commissioner, CGST & C. Ex., Indore [2022 (6) TMI 381 CESTAT New Delhi]

Facts

- Service tax demand was confirmed against the appellant on the ground that the penalty levied and collected from their contractor(s) during FY 2016-17 and April 2017 to June 2017 was liable to tax in terms of Section 66E(e) of the Finance Act.
- Section 66E(e) inter alia provided that declared services include agreeing to the obligation to refrain from an act or to tolerate an act or situation or to do an act.

CESTAT Held

- It was held that there was no contract between the appellant and their contractor – to refrain from an act or a situation or to do an act in favor of their contractor, or to tolerate any act or situation.
- Furthermore, there was no remuneration prescribed in the contract for such an alleged act or tolerance.
- Liquidated damages collected by the appellant from their contractor were in the nature of a penalty and not by way of any consideration for any service as defined in Section 66E(e).
- In this regard, CESTAT relied on its ruling in the case of **Lemon Tree Hotel vs. Commissioner, GST, CE & Customs, Indore** [2020 (34) GSTL 220 (Tri. Del.)], wherein it was held that the amount retained/forfeited by the hotel upon cancellation of a booking by the customer was in the nature of penalty, and not a consideration as defined under Section 66E(e) of the Finance Act.
- Accordingly, the appeal was allowed with consequential benefits to the appellant.

Our Comments

Since the Service Tax regime, the taxation of liquidated damages has been a subject matter of dispute between the taxpayers and the Revenue. This judgment is a welcome move to consider recovery of liquidated damages against forfeiture of contracts as a 'penalty,' not being subject to tax.

The judgment could also assist the taxpayers to substantiate their stand/ defend their position under the GST regime by considering liquidated damages (vis-à-vis agreeing to do an act/tolerance in terms of Entry 5(e) of Schedule II to the CGST Act.) in the nature of penalty, not exigible to tax.

M&A Tax Update

Chennai ITAT dismisses taxpayer's claim that letter to AO regarding merger is a valid communication and upholds revision of assessment order passed on amalgamating entity

IRIS Engineering Industries Pvt. Ltd. [TS-401-ITAT-2022(CHNY)] (Chennai ITAT)

Chennai ITAT has recently dismissed the taxpayer's appeal and upheld the revision of the assessment order passed on the amalgamating company IRIS Engineering Industries Pvt. Ltd. The ITAT noted that a letter was submitted with the Assessing Officer (AO) stating that the taxpayer was planning a merger with Ravilla Aerospace. However, no specific details about the amalgamation were filed with the tax authority. On the date of the assessment order, the AO had not received any concrete evidence that the entity had merged with Ravilla Aerospace, as the High court orders sanctioning the merger scheme were submitted with the Registrar of Companies (ROC), but not the AO.

Chennai ITAT distinguished the Maruti Suzuki[14] judgment of the Supreme Court from the current case, as in Maruti Suzuki's case, the AO was informed about the cessation of the company's existence. Chennai ITAT also considered the Supreme court case of Mahagun Realtors[15], where a similar issue was considered. It was held that the corporate death of an entity upon amalgamation per se shall invalidate an assessment order, but the same cannot be ordinarily determined on a bare application of provisions of the Companies Act and would depend on the terms of the amalgamation and facts of each case.

Our Comments

Following the decision of Mahagun Realtors, this is the second decision in line, highlighting the relevance of intimating the tax authority about the merger taking place. It is pertinent that due disclosures are made in the communications to the tax authorities, return forms, other income tax filings, etc., about the merger.

Bangalore ITAT remits appeal over AO's 'colorable device' finding on valuation report & goodwill in business acquisition

TE Connectivity Services India Private Ltd [TS-436-ITAT-2022(Bang)]

The taxpayer had acquired the shared service business of TE Connectivity Global Shared Services Ltd under slump sale and paid purchase consideration of INR 685.5 million. This consideration was based on an independent valuer's report prepared by using the weighted average of two internationally accepted methods, i.e., the Discounted Cash Flow method (DCF) and the Comparable Market Multiple methods.

The AO rejected the valuation report stating that the valuation using the DCF method is not acceptable. It concluded that the purchase consideration was a colorable device since it was fixed at an abnormally higher value than the net assets taken over (INR 76.4 million). It rejected the depreciation on the amortized cost of goodwill claimed.

The taxpayer's representative argued that AO failed to demonstrate and record any reasons for considering it as a colorable device. A colorable device is an instrument or a transaction designed to camouflage an underlying transaction. Also, a comparison of the projections with the actual revenues cannot be a basis for rejecting any valuation.

14. [2019] 107 taxmann.com 375 (SC)

15. Civil Appeal No. 2716 of 2022 [arising out of Special Leave Petition (C) No. 4063 of 2020]

Agreeing with these contentions, specifically in the context of valuation, Banglore ITAT also observed a similar issue was addressed by Delhi ITAT in the case of Rockland Diagnostics[16], wherein it was decided that the AO cannot reject the valuation report merely on the ground that the projected results did not match the actual results. In the context of Section 56(2)(viib) of the Income Tax Act, 1961, read with Rule 11UA of the Income tax Rules, 1962, every taxpayer has an option to do a valuation of shares and determine their Fair Market Value either by DCF method or Net Asset Value (NAV) method and that the AO cannot examine or substitute his own value in place of the value so determined.

Our Comments

Post the amendment vide Finance Act 2021, while goodwill is no longer eligible for depreciation for tax purposes, this decision would be of relevance in the context of valuation of other intangible assets, which are valued using varied methods.

While it is a settled position that valuation cannot be questioned merely because of variation of projections with actuals, it is pertinent to ensure that strong documentation is in place for the basis for projections made and where there is a variation of the actuals with the projections made, the reasoning for the variation is identified and suitably documented for ease of substantiation.

16. ITA No.316/Del/2019

Tax Talk

Indian Developments

Direct Tax

CBDT issues guidelines for the removal of difficulties in the implementation of Section 194R of the income tax act

Circular No.12 of 2022

- The government has finally provided clarifications, including valuation rules for withholding of taxes over benefits and perquisites provided to persons in the course of their business.
- The guidelines inter alia provide that Tax Deducted at Source (TDS) is to be done even if the perquisite is entirely in cash. It has further clarified that GST will not be included for the purposes of valuation of benefit/ perquisite.
- The Circular further clarifies that travel tickets booked by consultants and reimbursed by the client would require TDS to be done under this Section.
- It is clarified that while calculating the threshold of INR 20,000, the value of benefit or perquisite provided during 1 April 2022 till 30 June 2022 shall also be included.

CBDT inserts Rule 44FA for filing an appeal to high court against order U/S 245(1)

Notification G.S.R. 404(E) [F.NO. 57/2022/F. No. 370142/31/2021-TPL(Part III)] dated 31-5-2022

- For ease of filing an appeal to the High Court on a ruling pronounced or order passed by the Board for Advance Rulings under sub-section (1) of Section 245W, the CBDT introduced this rule.
- The form and manner of filing an appeal shall be the same as provided in the applicable procedure laid down by the jurisdictional High Court for filing an appeal to the High Court.

CBDT announces cost inflation index for FY 2022-23

Notification S.O. 2735(E) [NO.62/2022/F. NO.370142/20/2022-TPL] dated 14-6-2022

- In light of the explanation to Section 48 of the Act, CBDT published the cost inflation index for FY 2022-23.
- The cost inflation index for FY 2022-23 will be 331.
- It will be applicable from 1 April 2023 and shall apply accordingly to AY 23-24 and subsequent years.

Indirect Tax

Instructions on contents of refund orders, post-audit and review of refund claims

[Instruction no. 03/2022 – GST dated 14 June 2022]

Central Board of Indirect Taxes and Customs' (CBIC) GST policy wing has issued an instruction to bring uniformity in the practice adopted by GST officers for passing sanction orders and post-audit of GST refund claims. It highlights that:

- The proper officer should upload a 'speaking order' while accepting or rejecting a refund claim, covering all the contents specified in the instruction, such as details of the refund claim, documents submitted, deficiency memo, show cause Notice (SCN), and refund findings.
- The instruction covers specific refund scenarios, where additional details would be required to be included in the orders passed, which covers the refund of accumulated ITC, refund of tax paid on supplies being considered as 'Deemed exports', refund of the excess balance of cash ledger, and refunds being filed under other categories.

- The instruction also elaborates on the procedure to be laid down for 'post-audit' of all the GST refund orders issued in relation to refund claims amounting to INR 0.1 million or more, which calls for:
  - Immediate transmission of all the refund orders passed and providing access to supporting documents to the concerned officers;
  - Establishment of post-audit within three months from the date of refund order;
  - Completion of post-audit review within three months from the date of refund order;
  - Completion of review of refund order at least 30 days before the expiry of the time period allowed for filing an appeal by Revenue, i.e., within six months from the date of communication of order;
  - Provisions of supporting documents in offline mode till all documents are available on the Automation of Central Excise and Service Tax (ACES).

Extension in the time period for filing the Mega Power Project Certificate

[Notification no. 31/2022-Customs dated 7 June 2022]

The government has extended the time period for furnishing the final Mega power project certificate from 120 months to 156 months in terms of Notification no. 50/2017-Customs dated 30 June 2017. Furthermore, it has extended the period of validity of security in the form of Fixed Deposit Receipt or Bank Guarantee from 126 months to 162 months, in case of provisional mega power projects.

Restrictions on the export of sugar

[Notification no. 10/2015-20 dated 24 May 2022]

To curb the rapid rise in food prices, the government has limited the export of sugar over 10 million tonnes. This restriction has been made applicable from 1 June 2022 till 31 October 2022. To ensure price stability and domestic availability, the Indian government has prohibited sugar exports for the first time in six years.

Tax Talk

Global Developments

Direct Tax

OECD release public comments on Tax Certainty for Issues related to Amount A under Pillar One

[Excerpts from oecd.org, 27 May 2022]

A central element of Amount A is an innovative Tax Certainty Framework for Amount A, which guarantees certainty for in-scope groups over all aspects of the new rules, including the elimination of double taxation. This eliminates the risk of uncoordinated compliance activity in potentially every jurisdiction where a group has revenues, as well as a complex and time-consuming process to eliminate the resulting double taxation. The Tax Certainty Framework incorporates a number of elements designed to address different potential risks posed by the new rules.

A Scope Certainty Review, to provide an out-of-scope Group with certainty that it is not in-scope of rules for Amount A for a Period, removing the risk of unilateral compliance actions. An Advance Certainty Review, to provide certainty over a Group's methodology for applying specific aspects of the new rules that are specific to Amount A, which will apply for a number of future Periods.

Furthermore, a tax certainty process for issues related to Amount A will ensure that in-scope Groups will benefit from dispute prevention and resolution mechanisms to avoid double taxation due to issues related to Amount A (e.g. transfer pricing and business profits disputes), in a mandatory and binding manner. An elective binding dispute resolution mechanism will be available only for issues related to Amount A for developing economies that are eligible for deferral of their BEPS Action 14 peer review and have no or low levels of Mutual Agreement Procedure (MAP) disputes.

Senegal deposits ratification instrument for MLI

[Excerpts from oecd.org, 10 May 2022]

On 22 March 2022, interested parties were invited to provide comments on the Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard. The OECD is grateful to the commentators for their input and now publishes the public comments received.

On 1 June 2022, over 880 treaties concluded among the 74 jurisdictions which have ratified, accepted or approved the BEPS Convention will have already been modified by the BEPS Convention. Around 940 additional treaties will be modified once the BEPS Convention has been ratified by all Signatories.

Republic of Congo joins Global Forum as 165th member

[Excerpts from oecd.org, 20 June 2022]

The Republic of the Congo (Congo) joins the international fight against tax evasion by becoming the 165th member – and 34th African member – of the Global Forum on Transparency and Exchange of Information for Tax Purposes. The country's decision to join the Global Forum was made public on the last day of the 11th meeting of the Africa Initiative, which was held in Nairobi, Kenya, from 14 to 16 June 2022.

Members of the Global Forum include all G20 countries, all OECD members, all international financial centers and a large number of developing countries.

Like all other members, Congo will participate on an equal footing and is committed to combating offshore tax evasion through the implementation of the internationally agreed standards of Exchange of Information on Request (EOIR) and Automatic Exchange of Information (AEOI).

The Global Forum is the leading multilateral body mandated to ensure that jurisdictions around the world adhere to and effectively implement both the exchange of information on request standards and the standard

of automatic exchange of information. These objectives are achieved through robust monitoring and a peer review process. The Global Forum also runs an extensive capacity-building program to support its members in implementing the standards and help tax authorities make the best use of cross-border information sharing channels.

Transfer Pricing

New Jersey: Transfer Pricing settlement initiative program announced to expedite resolution of corporate intercompany pricing disputes

Commencing on 15 June 2022 and continuing through 2 March 2023, the New Jersey Division of Taxation (DoT) has implemented a voluntary initiative for corporate taxpayers incorporated in the state of New Jersey (taxpayer) to reduce and expedite the dispute resolution process for Intercompany Pricing Issues (IPI) and provide an efficient dispute resolution to the corporate taxpayers for all open tax years. The program is introduced to provide certainty and uniformity to taxpayers.

Scope and eligibility

The benefit of the initiative can be availed by all the corporate taxpayers (having filed their corporate income tax returns) who have entered into intercompany transactions that are subject to adjustment under the applicable laws. Eligible taxpayers include:

- taxpayers who are currently under audit;
- taxpayers notified of upcoming audit;
- taxpayers having pending appeals before the Conference and Appeals Branch; and
- unidentified taxpayers who have related party intercompany pricing in place.

The initiative would not be applicable to any pending cases of the taxpayer under litigation in any of the stages not covered above. Furthermore, it is not mandatory for the taxpayer to participate in all the open years. A taxpayer may participate in as many years as they choose.

Steps for application under the initiative

- In order to opt for the initiative, the taxpayer must by 15 September 2022, provide written confirmation to participate in the initiative by completing and emailing the **Election to Participate form**[17] to *TaxationTPInitiative@treas.nj.gov.*
- To participate in the initiative, it is imperative for the taxpayer to comply with all of the following terms and conditions:
  - The taxpayers are expected to fully cooperate and furnish all the required transfer pricing, tax, and financial information and documentation to the revenue authorities by 31 October 2022.
  - Time-limit for accepting the proposal offered by DoT is 30 days, wherein, the taxpayers may offer modifications or adjustments to the proposal within this time frame.
  - Discretionary extension to this 30-day timeline to be allowed on case-to-case basis.
  - The proposed adjustment is finalized post signing of **Closing Agreement**.[18]
  - The taxpayer shall pay all New Jersey tax and interest as determined under the Closing Agreement.
  - Rights to review or refund of any amounts paid for the covered period will be waived off under this initiative.

For taxpayers who successfully complete the pre-requisite terms and conditions of the said initiative, DoT shall propose a settlement amount and methodology based on information provided and principles prescribed under Internal Revenue Code. The settlement amount shall be mutually agreed upon by the parties and shall be open to all tax years, including the current year under audit. Furthermore, the DoT shall attempt to amicably settle any corporate tax issues for the tax periods covered by this initiative and waive off all applicable penalties, all rights to assess any additional tax, interest or penalties except for adjustments relating to federal corrections for all settled tax types.

Consequences of not participating

For taxpayers who do not opt for the initiative by 15 September 2022 or do not successfully complete the initiative, the revenue authorities shall assess the applicable penalties, not waive any penalties and conduct an audit as per the regular schedule without giving any relief for any unaudited open tax years.

17. Election to Participate in Transfer Pricing Initiative (nj.gov)
18. Form 906 - Closing Agreement (nj.gov)

Indirect Tax

Three-month gas tax holiday in the US

[Excerpts from Aljazeera.com]

In order to bring down the gas prices and give US citizens a bit of relief, President Biden has asked Congress and the State to suspend the federal gasoline tax of 18%, for a period of three months, till the end of September 2022. Furthermore, the states, many of which had surpluses in their budgets as a result of the federal pandemic stimulus, should likewise suspend their own gas taxes. He also urged refiners and gas station owners to ensure that "every penny" of the tax suspension reaches consumers.

UAE suspends export, and re-export of Indian wheat for four months

[Excerpts from arbianbusiness.com]

A moratorium on the export and re-export of wheat and wheat flour from India has been imposed by the UAE Ministry of Economy vide cabinet resolution No. 72 of 2022. The prohibition would also apply to free zones and will last for a period of four months starting from 13 May 2022. All types of wheat, including hard, common, and soft wheat, as well as wheat flour, are covered by the resolution.

5% VAT reduction on electricity bills in Spain

[Excerpts from express.co.uk]

Bearing in mind the rising inflation in the economy, Prime Minister Pedro Sánchez, announced that VAT on electricity will be halved from 10% to 5%. In the previous year, the Spanish government had slashed the VAT on electricity from 21% to 10%.

Elimination of grocery tax in Illinois

[Excerpts from usatoday.com]

The government of Illinois has decided to suspend the 1% tax on retail sales of groceries. The suspension will come into effect on 1 June 2022 and last till 20 June 2023. The temporary tax change applies to food for human consumption that will be consumed off the premises. Food packaged for immediate consumption, like soft drinks, candy, etc., will be taxed at the state sales tax rate of 6.25% plus any local taxes, if applicable. Medicine, drug items, and hygiene products will continue to be taxed at the 1% tax rate.

Compliance Calendar

Direct Tax
Indirect Tax

7 July 2022

- Due date for deposit of Tax deducted/collected for the month of June 2022

10 July 2022

- GSTR-7 for the month of June 2022 to be filed by taxpayer liable for Tax Deducted at Source (TDS)
- GSTR-8 for the month of June 2022 to be filed by taxpayer liable for TCS

11 July 2022

GSTR-1 to be filed by registered taxpayers for the month of June 2022 by all registered taxpayers not under QRMP scheme

13 July 2022

- GSTR-6 for the month of June 2022 to be filed by ISD
- GSTR-1 for the quarter of April 2022 to June 2022 to be filed by all registered taxpayers under QRMP scheme

15 July 2022

- Due date for issue of TDS Certificate for tax deducted under Section 194-IA, 194-IB,194-M in the month of May 2022
- Due date for filing of quarterly statement of Tax Collected at Source (TCS) deposited for the quarter ending 30 June 2022
- Due date for uploading the declarations received from recipients in Form No. 15G/15H during the quarter ending June 2022

20 July 2022

- GSTR-5 for the month of June 2022 to be filed by Non-Resident Foreign taxpayer
- GSTR-5A for the month of June 2022 to be filed by Non-Resident service provider of Online Database Access and Retrieval (OIDAR) services
- GSTR-3B for the month of June 2022 to be filed by all registered taxpayers not under QRMP scheme

22 July 2022

GSTR-3B for the quarter of April 2022 to June 2022 to be filed by registered taxpayers under QRMP scheme and having principal place of business in Category 1 states

24 July 2022

GSTR-3B for the quarter of April 2022 to June 2022 to be filed by registered taxpayers under QRMP scheme and having principal place of business in Category 2 states

30 July 2022

- Due date for issuance of quarterly TCS certificate in respect of tax collected by any person for the quarter ending 30 June 2022
- Due date for furnishing of challan-cum-statement in respect of tax deducted under Section 194-IA, 194-IB,194-M for the month of June 2022

SimplifiedGST

Delivering ease to GST Compliance

- GSTR-1
- ITC Reconciliation
- GSTR-3B
- Refunds

Schedule a Demo

31 July 2022

- Due date for filing of quarterly statement of TDS deposited for the quarter ending 30 June 2022
- Filing of return of income for non-corporate assessees who are not required to be audited for FY 2021-22
- Due date for claiming foreign tax credit, upload statement of foreign income offered for tax for the previous year 2021-22 and of foreign tax deducted or paid on such income in Form no. 67. (If the assessee is required to submit return of income on or before 31 July 2022.)

7 August 2022

Due date for deposit of Tax deducted/collected for the month of July 2022.

10 August 2022

- GSTR-7 for the month of July 2022 to be filed by taxpayer liable for TDS
- GSTR-8 for the month of July 2022 to be filed by taxpayer liable for TCS

11 August 2022

GSTR-1 to be filed by registered taxpayers for the month of July 2022 by all registered taxpayers not under QRMP scheme

13 August 2022

- GSTR-6 for the month of July 2022 to be filed by ISD
- Uploading B2B invoices using Invoice Furnishing Facility under QRMP scheme for the month of July 2022 by taxpayers with aggregate turnover of up to INR 50 million

Notes

Category 1 states - 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.

Category 2 states - 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.

Upcoming Webinars and Events

Webinar
15 July 2022
Virtual Training on Mergers & Acquisitions and Business Valuation
Organizer - Achromic Point

Register Here

Event
21 July 2022
GST & Customs - Contemporary Issues
Organizer - Achromic Point
Saket Patawari

Register Here

Webinars and Events

Webinar
30 June 2022
Fundamentals of UAE's FATCA/CRS Compliances
Organizer - Achromic Point
https://bit.ly/3bRDfNt

Webinar
9 June 2022
Uncovering the intricacies of UAE's Corporate Tax Regime
Organizer - Achromic Point
https://bit.ly/3bXc8Ay

Podcast
15 June 2022
Supreme Court's judgment on Ocean freight
Organizer - USIBC with Nexdigm and JSA
Saket Patawari
Listen: https://bit.ly/3NUzm8B

Event
7 June 2022
2nd Edition Tax Strategy and Planning Summit 2022
Organizer - UBS Forums
Exhibitor

Alerts

Notifications post 47th GST Council Meeting
7 July 2022
https://bit.ly/3AukWIo

MCA tightens provisions regarding the appointment of an individual from Key Highlights of GST Notifications and Clarification Circulars
6 July 2022
https://bit.ly/3IsQQGZ

Highlights from the 47th GST Council Meeting
1 July 2022
https://bit.ly/3R4qu1U

Ministry of Corporate Affairs introduces National Financial Reporting Authority Rules, 2022
24 June 2022
https://bit.ly/3OXhMBd

Insights

CBDT releases Updated Guidance on Mutual Agreement Procedure

23 June 2022
https://bit.ly/3c1pOL1

Government issues guidelines for withholding of tax over benefits and perks provided to business houses

17 June 2022
https://bit.ly/3nNufvq

The Companies (Appointment and Qualification of Directors) Second Amendment Rules, 2022

14 June 2022
https://bit.ly/3PgDEas

Business Closure - MCA amends rules pertaining to strike-off a company's name

13 June 2022
https://bit.ly/3ySsROl

In The News

Articles

Gujarat HC's respite to real estate buyers; Deemed land value only 'optional'

3 June 2022
bit.ly/3mPnqZL

Quotes and Coverage

Property Guru - Impact of GST on Real Estate

8 July 2022
Saket Patawari
CNBC Bajar
https://bit.ly/3c0Zh0c

GST E-invoicing Mandatory for Companies with Turnover of Rs 5cr and above

4 July 2022
Saket Patawari
Business World
https://bit.ly/3IsRtjP

'GST Council defers decision on 28% GST on casinos, online gaming; GoM to submit report by July 15

29 June 2022
Saket Patawari
Times Now News
https://bit.ly/3PivDCa

With no consensus, GoM may seek some more time

18 June 2022
Hindu Business Line
Saket Patawari
Print Edition

About Nexdigm

Nexdigm is an employee-owned, privately held, independent global organization that helps companies across geographies meet the needs of a dynamic business environment. Our focus on problem-solving, supported by our multifunctional expertise enables us to provide customized solutions for our clients.

We provide integrated, digitally driven solutions encompassing Business and Professional Services, that help companies navigate challenges across all stages of their life-cycle. Through our direct operations in the USA, Poland, UAE, and India, we serve a diverse range of clients, spanning multinationals, listed companies, privately-owned companies, and family-owned businesses from over 50 countries.

Our multidisciplinary teams serve a wide range of industries, with a specific focus on healthcare, food processing, and banking and financial services. Over the last decade, we have built and leveraged capabilities across key global markets to provide transnational support to numerous clients.

From inception, our founders have propagated a culture that values professional standards and personalized service. An emphasis on collaboration and ethical conduct drives us to serve our clients with integrity while delivering high quality, innovative results. We act as partners to our clients, and take a proactive stance in understanding their needs and constraints, to provide integrated solutions. Quality at Nexdigm is of utmost importance, and we are ISO/ISE 27001 certified for information security and ISO 9001 certified for quality management.

We have been recognized over the years by global organizations, like the International Accounting Bulletin and Euro Money Publications.

Nexdigm resonates with our plunge into a new paradigm of business; it is our commitment to ***Think Next.***

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