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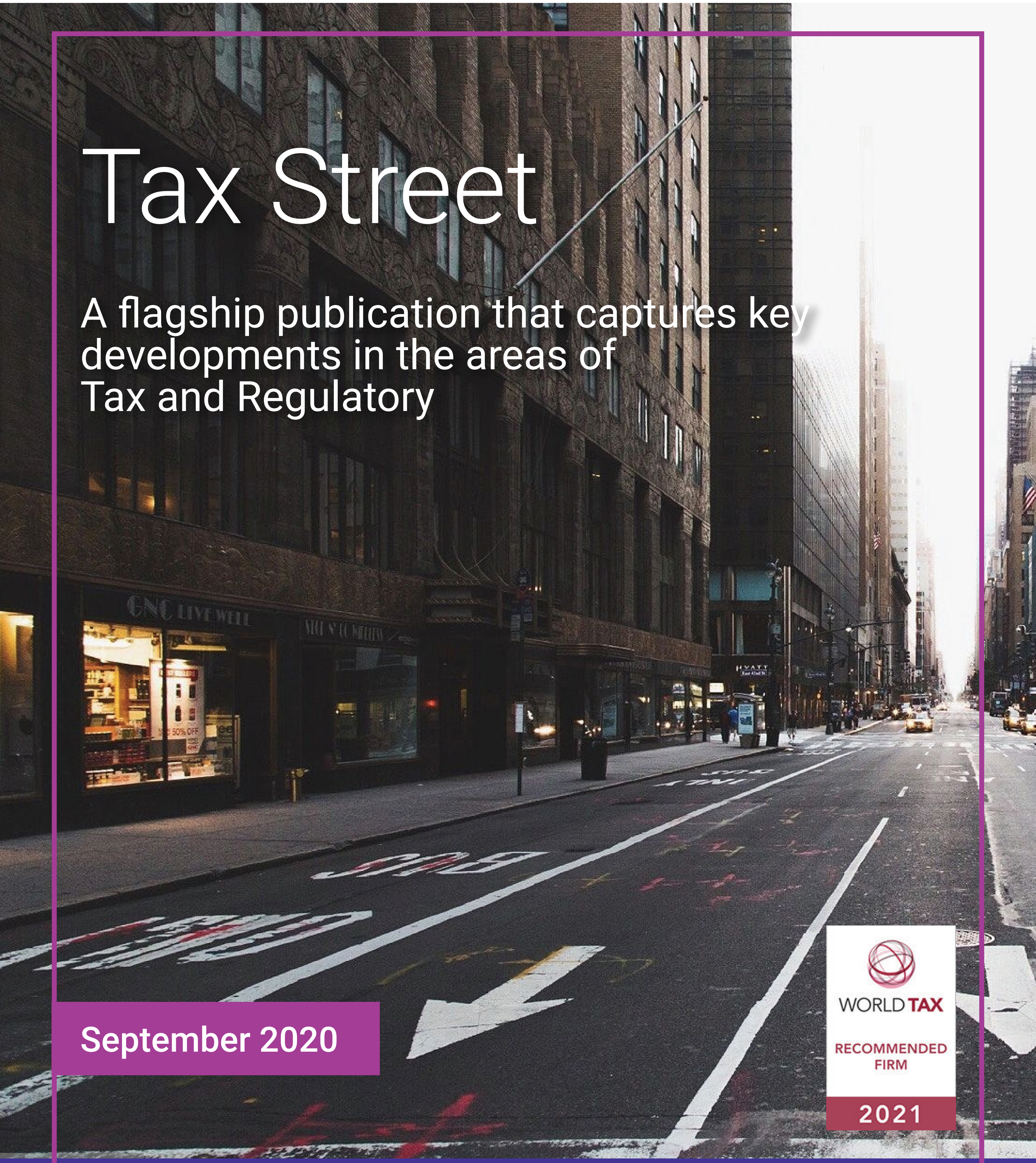

# Tax Street

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

September 2020

WORLD TAX

RECOMMENDED FIRM

2021

# Tax Street



# Stay Safe. Stay Healthy.

## Introduction

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 September 2020.

- The **'Focus Point'** covers an overview of Transfer Pricing guidance issued by different countries to address challenges due to COVID-19 crisis.
- 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@skpgroup.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 (SKP) Team

Focus Point

# An Overview of Transfer Pricing guidance issued by different countries to address challenges due to COVID-19 crisis

The COVID-19 pandemic has resulted in a worldwide disruption of business operations leading to severe losses and gaps in the supply chain for most businesses. Tax Authorities across the world have provided certain guidelines on transfer pricing requirements to be fulfilled by the businesses to avoid litigations in the times to come. The guidelines issued by countries such as Australia, New Zealand and Singapore predominantly elaborate on the difficulties that might be faced by the businesses in preparing the relevant documentation, the need, and base for term testing, APA arrangements, etc.

## Highlights of guidance issued by different Tax Authorities

### Australia

**i. Assess the economic impacts of COVID-19 on transfer pricing arrangements**

- **Functions, Assets and Risk profile (FAR):** The FAR profile of the entity before and after COVID-19.
- **Economic circumstances:** The taxpayer will need to outline and provide evidence for the actual economic impact of COVID-19 on its business operations. Further, this impact may be supported by a broader analysis of how the relevant industry is affected in which the taxpayer operates.
- **Contractual arrangements:** The taxpayer will need to explain the impact on contractual arrangements between himself(taxpayer) and its related parties (including termination clauses, penalty notices, force majeure, or other clauses if applicable).
- **Impact on the product and/or service offering:** The taxpayer will need to demonstrate the impact of COVID-19 on the specific product and/or service offerings it is dealing with and how this has affected the financial results.
- **Business strategies:** The taxpayer will need to provide evidence related to the changes in its business strategies as a result of COVID-19. This may include key decisions made, expected outcomes, and actions taken to give effect to those strategies.
- **Change in/ impact on business:** The taxpayer will need to gather evidence to support any changes to the business or impacts on the business as a result of COVID-19.

**ii. How to support the arm's length nature of transfer pricing outcomes:**

- The Australian Taxation Office (ATO) had acknowledged that the analyses of comparable company benchmarking might not reliably support the arm's length outcomes of the continuing transfer pricing arrangements where they are impacted by COVID-19. On this basis, the ATO has stated that they will seek to understand the financial outcomes that are achieved by the taxpayers and which are impacted due to COVID-19. This analysis may include:
- A detailed profit and loss analysis (including variance analysis of budgeted (pre-COVID) versus actual results);
- Details of adjusted profitability if COVID-19 had not occurred;
- Rationale and evidence for any increased allocation of costs or a reduction of sales taking into consideration its FAR profile;
- Evidence of any government assistance provided or affecting the Australian operations.

**iii. Practical Compliance Guideline (PCG) 2019/1[1] and COVID-19 impact**

The ATO has specified that they are not currently seeking to review PCG 2019/1 due to the effect of COVID-19. They will consider the appropriateness of PCGs where analysis or further benchmarking indicates there is a material movement in the information used to develop the risk assessment framework.

**iv. Advance Pricing Arrangement (APA)**

**a. Breaching an APA due to COVID-19**

The ATO has acknowledged the fact that business operations that are negatively impacted due to COVID-19 can result in a breach of critical assumptions based on which the APA was agreed. In such circumstances, the ATO has encouraged the taxpayers to engage as soon as an APA breach occurs or is likely to occur. Further, based on the assessment of breach, the ATO has indicated that the likely outcomes could be:

- No change in the agreed APA; or
- Renegotiating the APA over the time period of the demonstrable impact; or
- Suspending or modifying the APA for a set period.

**b. Those currently in an APA process without an agreed APA**

The ATO has clarified that standard APA processes and analyses will apply where the economic performance of the taxpayer is not significantly impacted by COVID-19. Further, they are willing to place APA cases on hold or mutually end the APA process where the taxpayer is significantly affected by COVID-19. With regard to bilateral APAs, it has been clarified that it will need to be considered in consultation with the corresponding jurisdictions.

1. *PCG provide broad law administration guidance, addressing the practical implications of tax laws and outlining ATO's administrative approach. These guidelines can provide taxpayers with additional certainty and compliance savings, and allow the ATO to direct their compliance resources to higher risk areas of the law.*

## New Zealand

**1. Arm's length principle**

- Transactions must continue to be conducted in accordance with the arm's length principle during the COVID-19 pandemic based on existing OECD TP Guidance issued in July 2017. The New Zealand Tax Authorities have recognized that practical difficulties in applying the arm's length principle may arise during this time. It is critical to have contemporaneous documentation recording specific facts and circumstances faced by the businesses and their compliance with the principle.

**2. Documenting COVID-19 impacts**

- Identify and collate evidence to document the nature, duration, and extent of any material COVID-19 related impacts on the group and local business;
- Document relevant group and local business' responses to the pandemic, including, for example, any changes in business strategies, changes in the characteristics of product or service offerings and so forth;
- Identify and explain any changes in the group and local business functions, assets and risks during the impacted period, including how these relate to the business' exposure to, or mitigation of, COVID-19 impacts;
- Identify and explain any changes in intra-group transactions and contractual terms;
- Document the supporting rationale for any changes to intra-group transfer prices, including why they are considered to be arm's length in the circumstances;
- Identify the impact of COVID-19 on the overall profitability of the MNE group and the local entity.

**3. Arm's length support for financial outcomes**

- In exceptional economic circumstances, identifying reliable, comparable data to support the arm's length nature of financial outcomes may be difficult, particularly in the short term. In the absence of comparable data, a pragmatic approach is to refer to pre-COVID-19 expectations and analyze variances that have arisen due to COVID-19 impacts, both positive and negative. This includes quantifying the financial consequences of the identified COVID-19 impacts, providing supporting evidence for the analysis and explaining in detail:
- Why local sales are lower than expected;
- Why local expenses are higher than expected;
- Any unusual financial items;
- Any government assistance received;
- The impact of any amended intra-group transactions; and
- Any adjustments made.

## Singapore

**i. TP Documentation**

In light of the potential COVID-19 impact, companies are advised to provide additional qualitative information in their transfer pricing documentation to substantiate the arm's length nature of their transfer pricing outcome. The list of additional qualitative details includes, the effect of COVID-19 on the industry and the impact on the taxpayer, comparative functional analysis, change in related party arrangements, compare the change in financial results and variance analysis, justify the impact of COVID-19 on the profitability results and specify if any specific government assistance is received.

**ii. Term Testing**

Taxpayers were required to consult the Singapore Tax Authorities before applying term testing (combining multiple-year financial results as against annual results). Considering the potential impact of COVID-19, taxpayers are advised that they need not consult the IRAS for application of term testing if the annual testing may result in volatile results due to the impact of COVID-19.

**iii. APA**

Singapore Tax Authorities will continue to accept the new APA application. Regarding APA application in progress, the taxpayer should assess whether any transfer pricing implications are arising from COVID-19, which may impact the APA application. If so, the taxpayer is encouraged to provide the relevant details for the same.

Regarding the existing APA, the taxpayer should review and assess whether there is any breach of the terms and conditions in the existing APA agreement and notify the same to the Singapore tax authorities. Further, where there is an existing APA that covers the COVID-19 period, the taxpayer should evaluate if COVID-19 does not significantly impact the business operations and economic performance. In case of any significant impact, the taxpayer may choose to consider filing a new APA application rather than a renewal.

**iv. Conclusion:**

The guidance provided by the tax authorities in Australia, New Zealand, and Singapore is a well-timed reminder for taxpayers that are members of a multinational group that historic transfer pricing approaches will not be suitable for the financial years impacted by COVID-19. A detailed evaluation is required to assess the impact of these peculiar circumstances generated by COVID-19 on the business. The relevance of such an analysis is crucial, given the relatively unique economic circumstances applicable to businesses and individuals in the relevant jurisdictions.

## What to expect from the Indian Tax Authorities?

### Transfer Pricing Documentation

The Indian Tax Authorities should adopt a similar approach to issue guidance to taxpayers about COVID-19's effect on transfer pricing policies. They can provide a set of detailed FAQs on the below aspects based on the experience gathered till date while dealing with the taxpayers at different forums (i.e., transfer pricing audits, APA, safe harbour, etc.).

- Insights on identifying and collating evidence to document the impact of COVID-19 on the business. Illustrations and practical scenarios can be provided w.r.t. what is the level of documentation expected from the taxpayer to support the economic impact of COVID-19.
- Any changes in the group and local business FAR, intra-group transactions, and contractual terms during the impacted period. Whether one-time (short term arrangement) effect of the transfer of FAR to another location will lead to an outcome of restructuring and resultant exit charge obligation on the taxpayer.
- Document to support any changes to intra-group transfer prices, including why they are considered to be arm's length in the circumstances.
- Factors to identify the impact of COVID-19 on the overall profitability of the MNE group and the local entity.

### Guidance to support Arm's length outcome

Given that the Indian Tax Authorities have historically adopted the approach outlined above to verify the profitability earned by the taxpayers (in case of a loss scenario or when profits are understated), there is an increased obligation on the taxpayers to make sure that such analysis is carried out and maintained in order to defend a possible operating loss scenario or low profit margins for both the current, and coming years due to COVID-19.

Benchmarking analysis for determining the arm's length price in consequence of COVID-19 may prove to be a cumbersome task with regard to transfer pricing arrangements entered into during FY 2019-2020 and FY 2020-2021. This can be more specific pertaining to:

a. Usage of weighted average financial data points of the comparable companies for the latest three FYs against the weighted average result of the taxpayer for three FYs;

b. Usage of single year financial data of the comparable companies for the current year against the result of the taxpayer for the current year;

c. Guidance on how economic adjustments, albeit downturn adjustments in the COVID-19 scenario (e.g., capacity utilization, working capital, overall industry movement, etc.) should be made on the comparable companies; and

d. Treatment of the outlier comparable companies in the comparability analysis, especially high loss-making companies, to even out the impact of COVID-19.

### Safe harbour law provision

As of now, there is no guidance on safe harbour provisions for FY 20-21 and whether safe harbour rates would be revised based on the impact of COVID-19 disruptions. However, it will definitely be a positive and welcome move for the taxpayers if the Indian Tax Authorities can shed some light on whether they can expect a decrease in the existing mark-up percentages for different categories of transactions covered in the safe harbour provision in the backdrop of COVID-19 crisis.

### APA

Indian Tax Authorities should acknowledge the practical challenges faced and take cognizance of changes in the business arrangements/ models due to the COVID-19 crisis and re-look at the agreed APAs. For instance, the transfer pricing models may need to be adjusted to come in line with any business motivated changes made to the global supply chain, and ensure they reflect any re-allocation of functions, assets, and risks across the group. Detailed guidance should be issued on the below aspects:

- New APA applications;
- APA applications in progress; and
- Existing APA (that are already concluded).

It is imperative for the Indian Tax Authorities to issue guidance that would outline the nitty-gritty for unilateral and bilateral APA in the aftermath of COVID-19.

# From the Judiciary

## Direct Tax

### Whether withholding of tax can be applicable to the reimbursement of expenses to a non-resident?

Bangalore International Airport Vs
The Income-tax officer
ITA Nos. 536 to 539/Bang/2006

***Background***

The government had proposed to develop an airport with private sector participation. The Karnataka State Industrial Investment Development Corporation (KSIIDC) was appointed as the Nodal Agency for undertaking all the activities towards the development of the airport as a joint venture. The Government of India also authorized the Airport Authority of India (AAI) to participate in the development of the project.

AAI and KSIIDC floated a global tender for private partners who can hold a 74% stake of the airport. As an outcome consortium consisting of SIEMENS Germany, UNIQUE Switzerland, and L&T, India were chosen as private partners. Ultimately, the taxpayer was incorporated with the chosen private partners, along with AAI and KSIIDC.

Prior to incorporating the taxpayer, the cost was incurred by the private partners for a feasibility study and development of the airport project. As per the shareholders' agreement, such pre-development cost was reimbursed to the non-resident private sector without withholding any taxes. The taxpayer was of the view that the payment was purely reimbursement of expense, and in the absence of any income element, no withholding of tax would be required. The contention was backed by a special bench decision in the case of Mahindra & Mahindra.

The Assessing Officer (AO) considered the reimbursed expenses as Fees for Technical Services (FTS) and made additions. On appeal, the CIT(A) concurred with the AO. Relying on the decision of the Authority of Advance Ruling (AAR) in the case of Danfoss Industries Private Ltd, the CIT(A) was of the opinion that as long as the payments are in the nature of sums chargeable to Indian tax, one need not go to the question of profit element. Since the nature of services rendered for which payment was made is FTS, the payment should be subject to withholding tax.

***Held***

The Bangalore ITAT was of the view that the non-resident had no obligation to bear expenses in his individual capacity. Even going by the averments of the AO that the payment made to the consultants engaged by the non-resident was in the nature of FTS, the payment in question is not made to the consultants but to the non-resident by way of reimbursement.

The tribunal appreciated the fact that the decisions of the AAR are binding only on the parties to the ruling, and it would have persuasive value as a precedent. However, the special bench's decision, in the case of Mahindra & Mahindra, would be binding as a precedent.

**Our Comments**

Withholding tax on reimbursement of expenses has always been a persistent issue of debate. There are various judicial precedents, both supporting and against the withholding of taxes on reimbursement.

The decision is rendered based on the favorable special bench decision in the case of Mahindra & Mahindra. However, the revenue has not pointed out any other negative decisions in this context.

This could be a welcome decision in this context; however, while adopting such a view, the taxpayer (especially deductors) should be cautious about the against rulings in this context.

### Whether payment for the inspection services rendered by the non-resident can be considered as Fees For Technical Services (FTS)?

DCIT Vs M/s Jeans Knit Pvt. Ld
ITA No 383 of 2012 (Karnataka High Court)

***Background***

The taxpayer is engaged in the business of manufacturing and export of garments and is a 100% export oriented undertaking. The taxpayer requires to import accessories from other countries, mostly from Europe. For the aforesaid purpose, it had engaged a non-resident company to render services such as inspection of fabrics, timely dispatch of material, etc. The taxpayer made payment to the non-resident without withholding of tax. It was of the view that the non-resident does not require any technical knowledge for rendering the aforementioned services. The taxpayer already determines the quality of the material, and the non-resident company is only required to make a physical inspection of the material to examine if it resembles the quality specified by the assessee.

The AO inter-alia held that the non-resident company is a service provider, and the services rendered by the non-resident company would be squarely covered under the definition of FTS. The decision of the AO was concurred by the CIT(A).

The tribunal, vide its order, held that the non-resident company is not involved either in the identification of the exporter or selecting the material and negotiating the price. Only comparing the samples provided by the assessee does not require any technical knowledge.

Aggrieved by order of the tribunal, the revenue filed an appeal with the High Court.

***Held***

The Hon'ble High Court (HC) upheld the order of the tribunal. The HC went a step ahead and held that it is a well-settled legal proposition that the tribunal is a fact-finding authority and decision on facts rendered by the tribunal can be gone into by HC only if a question is referred to it, which says the finding is perverse. Given that the tribunal's finding has neither been assailed by the revenue as perverse and even in the memo of appeal, no perversity has been even alleged, no substantial question of law arises.

**Our Comments**

Whether a payment would qualify to be FTS or not cannot be standardized. It is a matter of factual analysis. Individual services need to be analyzed while determining taxability. In cases where the only inspection is required based on the sample provided by the party, the same should not be considered as FTS.

### Whether refund of taxes withheld can be allowed on the income not assessable to tax in the hands of the taxpayer?

M/s. ABB AB C/o ABB India Limited Vs DCIT
ITA No 464/Bang/2018 & 2878/Bang/2019

***Background***

The taxpayer, ABB AB, is a tax resident of Sweden within the meaning of DTAA between India and Sweden. The taxpayer is engaged in power and automation technologies for utility and industry customers. The competent authorities of India and Sweden in the taxpayer's case had arrived at a resolution through Mutual Agreement Procedure (MAP) for the AY 2013-14 and 2014-15 that the receipts under the offshore supply contract and onshore supply contracts are not chargeable to tax in India.

For the concerned year, the taxpayer filed its return of income, claiming a TDS refund to the tune of INR 28,56,25,430. However, the AO passed an order under section 143(3), allowing TDS credit of only INR 1,71,15,646.

The AO was of the view that the income is subject to tax in India as the MAP resolution does not cover the concerned year. Further, the source for the offshore supply contract is in India; hence, the receipts are taxable in India. Since the invoices of the concerned year were relating to advances and not the supply of equipment, the AO concluded that as per section 199, the credit for taxes deducted at source could be given only when the corresponding income is offered to tax.

The taxpayer pleaded that the taxpayer company's payments for the offshore supply contract are not applied in India as the title is passed outside India, and payment is also received in India. The provision of Section 199 of the Act and Rule 37BA of Income Tax Rules will not be applicable, where the payments are not taxable in India.

The CIT(A) upheld the order of the AO. Aggrieved by such order, the taxpayer has filed an appeal with the tribunal.

***Held***

After considering the argument of both sides, the Bangalore tribunal followed the decision of the co-ordinate bench in the case of Arvind Murjani brands (P) Ltd.

In such case, it was held that section 199 had been enshrined in the Act to give a logical conclusion to the earlier sections under which tax is deducted at source from various items of income as enumerated therein so that credit for the tax deducted at source is allowed to the person while assessing the income in the hands of the payee. The role of section 199 is confined to allowing the credit for the tax deducted at source to the payee of the amount and none else. Thus it is evident that section 199 only deals with allowing of the credit for the tax deducted at source and not with the disallowing of such credit. Since the offshore supply contracts are not taxable in India, but TDS was deducted in India; therefore taxpayer is eligible for a refund of TDS Credit.

However, the case was remitted back to the AO for the limited purpose of verification and examination whether the amounts received are offshore supply contracts by the taxpayer were received outside the country.

### Our Comments

The decision highlights the principle that the provisions of the Act are to be interpreted, keeping the spirit of the law into consideration.

## Transfer pricing

### Whether business advance to loss-making AE should be treated as a loan to AE?

KEC International Ltd - ITA No. 17/Mum/2018 and ITA No. 115/ Mum/2018 – AY 2012-13

***Facts***

The taxpayer is engaged in the business of designing, fabrication, galvanizing, and testing of transmission lines and telecom towers, supply and erection of substation structures and overhead equipment for railway electrification, and managing infrastructure sites for telecommunication services. The taxpayer held a 50% share in a Joint Venture (JV) in South Africa.

During the year, the taxpayer had given advances to its Associated Enterprise (AE), i.e., the JV entity, amounting to INR 27.32 crores to meet the deficit in cash flows while executing projects in South Africa. Since the transaction was stated to be in the nature of advances, no interest was charged during the year. For benchmarking the transaction, the taxpayer selected AE as the tested party. The loan availed by AE from the UK based Bank at three months LIBOR + 120 basis points was used as an internal Comparable Uncontrolled Price (CUP) to benchmark the transaction.

During the course of the assessment, the Transfer Pricing Officer (TPO) rejected the taxpayer's internal CUP and adopted interest rates applicable for fixed rates loans, i.e., LIBOR plus some spread. Adopting the Bloomberg database, the benchmark rates were held to be 15.36% for FY 2010-11 and 11.29% for FY 2011-12. Applying the said rates to opening advances and fresh advances, TPO proposed net Transfer Pricing (TP) adjustment at INR 2.43 crores.

Commissioner of Income Tax – Appeal / CIT (A) confirmed the adjustment, against which the taxpayer filed an appeal before Income Tax Appellate Tribunal (ITAT).

***ITAT held as under:***

- Based on the financial statements of the AE, it is observed that AE has incurred losses, which had primarily triggered the taxpayer to make the stated advances.
- The advances were towards the fulfillment of the taxpayer's obligation of being a JV partner as any financial incapacitation of JV would adversely affect the continuation of the project and ultimately jeopardize the interest of the taxpayer.
- Further, it could not be said that the JV entity derived/gained certain benefits out of such advances, but rather, it was the taxpayer who would ultimately gain by continuing with the projects and taste the fruits of the success of the project.
- Therefore, the said advances could not be put in the category of loans as done by the lower authorities. Held that, the advances were more in the nature of the capital contribution.

Therefore, ITAT deleted the adjustment.

### Our Comments

Under the Indian Transfer Pricing Regulation, advances between AEs are considered as an international transaction and are required to be at arm's length.

The **business advances made by the taxpayer to AEs as a matter of commercial prudence** (to avoid any financial incapacitation of the AE) cannot be considered in isolation without considering crucial business scenarios and expediency. In such cases, since the cost and benefit would ultimately accrue to the taxpayer, the same **cannot be treated as a loan to AE.** Consequently, no interest is warranted to be charged on such business advances.

## Whether comparable prices from TIPS Data Base are acceptable as a CUP for chemical imports?

Dow Chemical International Pvt Ltd - ITA No. 1786/ Mum/ 2016 – AY 2011-12

*Facts*

The taxpayer is engaged in manufacturing specialty chemicals, distribution of chemicals, and undertaking marketing support activities for overseas group companies. During the year, the taxpayer has imported raw materials amounting to INR 232 crores from its AEs. Applying the Cost Plus Method (CPM), the taxpayer has compared its gross margin with third party comparable companies and justified the arm's length value of the transaction.

During TP assessment, TPO rejected CPM and adopted the Transactional Net Margin Method (TNMM), thereby proposing a TP adjustment of INR 38 crores in respect of the import of raw materials. In the appeal, the Dispute Resolution Panel (DRP) upheld the adjustment, rejecting the CUP data using ICIS* prices submitted by the taxpayer.

* *Market prices published by Independent Chemical Information Services (ICIS), which reports prices based on a contract between third parties and which is relied upon by the chemical industry to fix their prices.*

Aggrieved, the taxpayer filed an appeal before ITAT.

*ITAT held as under*

- The taxpayer had filed additional evidence to substantiate the comparison of its import price with prices available on the TIPS database for 95.79% of the raw materials imported from AEs. It was noted that ICIS prices covered a lesser percentage of the total value of import transactions from AE.
- It was observed that TIPS Database maintained by the Customs Department has also been accepted by the Delhi Tribunal in the case of Tilda Riceland Pvt. Ltd. and in the taxpayer's own case for AY 2010-11 and AY 2014-15.
- In view of the fluctuating prices for the product, ITAT directed the TPO to adopt a portfolio approach considering both favorable and adverse prices while benchmarking the import transaction.
- Remitting the matter for verification, ITAT stated that if the taxpayer's import prices are lower than the comparable prices reported by TIPS Database, the balance imports of 4.21% will also be considered to be at arm's length, thereby not warranting any TP adjustment.

Therefore, ITAT has remitted the matter to TPO to verify the details.

### Our Comments

We have observed that the application of CUP is difficult for import transactions considering the high degree of accuracy required in terms of comparability.

However, this ruling has laid down the jurisprudence, whereby **we can consider comparable prices available on the ICIS or the TIPS database as valid CUP while benchmarking import transactions pertaining to the chemical and related industries.**

This ruling shall help especially in cases for benchmarking import transactions, where there are losses at net level incurred.

## Whether royalty payment approved by the Reserve Bank of India (RBI) can be considered at arm's length?

Thyssenkrupp Industries India Pvt. Ltd. - C.O. NO.94/MUM/2014 – AY 2009-10

*Facts*

The taxpayer is engaged in the manufacturing of industrial machinery and equipment. The taxpayer received technical assistance and know-how from its AE for which a royalty of 2% of the contract value for manufacturing, drawing, and engineering services and 5% of the selling price was paid.

The royalty agreement was approved by the RBI and Foreign Investment Promotion Board (FIPB). The taxpayer selected itself as the tested party and TNMM as the most appropriate method for benchmarking. During assessment proceedings, the TPO determined the arm's length price (ALP) of the royalty transaction at 'Nil' and proposed a TP adjustment of INR 5.98 crores.

In an appeal, the DRP has deleted the TP adjustment, placing reliance on the taxpayer's own case for AY 2008-09. Aggrieved, the Revenue has filed an appeal before ITAT.

***In the taxpayer's own case for AY 2008-09, ITAT held as under:***

- The taxpayer had applied to the RBI seeking approval in respect of payment of royalty and technical fee through the Central Bank of India. The RBI, vide its letter, requested the Bank to consider the taxpayer's case in accordance with its AP (DIR Series) No.76 Circular* requiring explicit approval from RBI/FIPB only in case royalty payments exceed 5% on net domestic sales and 8% on net export sales. Since the taxpayer's royalty payments to AE did not exceed the threshold, they were deemed to be approved by the RBI under the automatic approval scheme.

  ** In this regard, we wish to highlight that the royalty caps vide the aforementioned Circular have been removed since 2009. It should also be noted that royalty transactions for most of the sectors are currently under the automatic route (not requiring explicit approval from RBI)*

- When the royalty payment has been approved or deemed to be approved by the RBI, the royalty payment is considered to be at arm's length.

Therefore, ITAT deleted the adjustment.

**Our Comments**

Royalty payments are increasingly coming under tax scrutiny, making it incumbent on the taxpayers to defend their royalty payments made to overseas related parties to be at arm's length.

**Divergent views have been taken on the use of RBI guidelines for testing the arm's length nature of royalty transactions.** A contrary view was taken in the case of Nestle India Ltd *[ITA Nos. 662 & 1202 of 2005, 96 & 294 of 2008, 288 of 2011]* wherein the Delhi High Court clarified that RBI's permission for payment would not preclude the TPO from questioning the reasonableness and genuineness of the transaction.

The **onus lies on the taxpayer to demonstrate the need and benefit derived from royalty payments as well as to maintain proper documentation,** which would serve as a concrete basis for considering royalty payments to be at arm's length.

## Indirect Tax

### Whether Rule 89(5) of the CGST Rules, 2017 is ultra vires the GST law, and therefore can an applicant be allowed refund of Input Tax Credit (ITC) on input services in case of supplies under inverted duty structure?

Tvl. Transtonnelstroy Afcons Joint Venture Vs. Union of India [2020 (9) (TMI) 931]

***Facts***

- The petitioner claims refund of ITC on account of inverted duty structure as per section 54(3) of the CGST Act, 2017;
- Notification No. 21/2018-CT dated 18 April 2018 amended the said Rule to deny refund on the ITC availed on input services and allowed relief of refund of ITC availed on inputs alone;
- This amendment was later given a retrospective effect from 1 July 2017;
- In the case of VKC Footsteps India Pvt. Ltd., (covered in the August 2020 edition of Tax Street), the Gujarat HC held that the formula in Rule 89(5) to exclude refund of tax paid on 'input service' is contrary to the provisions of Section 54(3).

***Based on the above facts, the Madras HC ruled as follows:***

- The proviso to Section 54(3) performs a larger function of limiting the entitlement of the refund to credit that accumulates as a result of the rate of tax on input goods being higher than the rate of tax on output supplies;
- Section 164 confers power on the Central Government to frame rules for carrying out the provisions of the CGST Act, and no fetters are discernible therein;
- Consequently, Rule 89(5) of the CGST Rules, as amended, is intra vires both the general rulemaking power and Section 54(3) of the CGST Act;
- Further, the Section uses the word 'inputs,' and this word is defined in Section 2(59) as "any goods other than capital goods ….";
- Section 54 contains more than a few usages of the terms' inputs' and 'input services' in other sub-sections, thereby indicating the legislative intent to distinguish one from the other;
- Hence, the statutory definition and the context point in the same direction, namely, that the word 'inputs' encompasses all input goods, other than capital goods, and excludes input services;
- Consequently, it is not necessary to interpret Rule 89(5) and, in particular, the definition of Net ITC therein so as to include the words input services.

**Our Comments**

This judgment of the Madras HC has again resulted in a scenario wherein different High Courts have given contrary decisions on the same issue. Nevertheless, the Revenue will definitely see this as a big victory given that the Court has specifically referred to the judgment in VKC Footsteps and disagreed with the same stating, that the Gujarat HC failed to take into consideration the scope, function, and impact of the proviso to Section 54(3).

Businesses may have to revisit and rethink any change in tax positions they may have adopted in light of the VKC Footsteps judgment and will have to wait for the Supreme Court to rule on the matter for it to attain finality.

## Industry Insights

"The Madras High Court judgement is bound to take wind out of the sails of the industry which is already reeling under economic hardships inflicted by the pandemic. The contradictory judgements by different Courts once again emphasize the need for legislative clarity on crucial tax issues in the GST regime. Without waiting for the matter to attain finality before the Supreme Court, the GST Council, as a trade facilitation measure, should revisit the issue and bring in an amendment in the GST law to allow refund of ITC pertaining to input services in case of refund on account of supplies under inverted duty structure. The step from GST Council will help industries regarding working capital liquidity and ease of doing business.

**Abhishek Rai**
**Finance Controller**
**Bic Cello India**

i. Whether ITC is available to the applicant on GST charged by the service provider on the hiring of bus/motor vehicle having a seating capacity of more than 13 persons for the transportation of employees to and from the workplace?

ii. Whether GST is applicable on the nominal amount recovered by the applicant from its employees for the usage of employee bus transportation facility in non-air-conditioned buses?

[Background: Section 17(5)(b)(i) of the CGST Act has been amended, with effect from 1 February 2019 to block ITC on leasing, renting, or hiring of motor vehicles having approved seating capacity of not more than 13 persons.

As per Notification No. 12/2017-CGST, transport of passengers in non air-conditioned contract carriage is exempt from GST]

Tata Motors Ltd - Authority for Advance Ruling (AAR), Maharashtra [2020 (9) TMI 352]

### *Ruling for Question (i)*

- We have no doubt that in the subject case, the supply of services received by the applicant is used in the course or furtherance of their business, and therefore prima facie, they are eligible to take credit of GST charged by their suppliers;
- Further, in the subject case, since the applicant has specifically submitted and, as agreed by the jurisdictional officer, that they are using motor vehicles having approved seating capacity of more than 13 persons (including the driver), the applicant shall be eligible for ITC.

### *Ruling for Question (ii)*

- The applicant is not providing transportation facilities to its employees. In fact, the applicant is a receiver of such services in the instant case;
- Therefore, the applicant's contentions that they are eligible for exemption from GST in respect of nominal amounts of recoveries made from their employees towards bus transportation service is not correct;
- Since the applicant is not supplying any services to its employees, in view of Schedule III to the CGST Act, we are of the opinion that **GST is not applicable to the nominal amounts recovered by applicants from their employees in the subject case.**

### Our Comments

Schedule III to the CGST Act excludes services provided by an employee to the employer from the ambit of GST [i.e., in such a case 'consideration' viz. salary, allowance, etc. flows from the employer to the employee]. The AAR's reliance on the same for excluding recovery of nominal amounts by the employer from the employees appears to be misplaced.

However, the applicant has accepted that its ITC will be restricted to the extent of the net cost borne by it in view of the judgment of the Bombay High Court under the erstwhile CENVAT credit rules in the case of ***CCE, Nagpur vs. Ultratech Cement Ltd., [2010 (10) TMI 13]***. Therefore, there is revenue neutrality from the point of the exchequer.

# Tax Talk

Indian Developments

## Direct Tax

### Faceless assessment of income tax may face these 10 major roadblocks ahead

[Excerpts from Financial Express, 27 August 2020]

The faceless scheme is a very prominent initiative by the government. Though it has a number of perks linked to it, certain practical challenges need to be addressed for the scheme to be successful. A few challenges are listed below:

- Income tax employees' resistance to the change;
- Ability of tax officers to assess and understand the technicalities purely on a virtual platform;
- Need for professional assistance - With the majority of small and mid-segment taxpayers and their accountants being familiar in local languages, a fully electronic assessment process would be difficult to manage, thereby forcing them to seek professional assistance, which could be expensive;
- Restricted response (message) on the e-filing portal;
- Maintenance of digital records requires huge storage capacity;
- Cybersecurity concerns;
- Additional time for completion of assessments.

### Banks asked to refund charges collected for UPI, digital payments after 1 January 2020

[Excerpts from LiveMint, 30 August 2020]

As India now aims to become a digital-payments driven economy, CBDT said that banks could not levy any extra charge on transactions made through electronic modes on or after 1 January 2020. According to the relevant section of the Payment and Settlement Systems Act 2007 (PSS), no bank or system provider shall impose any charge on a payer making payment or beneficiary receiving payment through electronic modes prescribed under Section 269SU of the IT Act. A breach of such provisions attracts penalties under Section 271DB of the Income-tax Act as well as Section 26 of the PSS Act. Accordingly, the banks were advised to refund charges collected from customers for a digital transaction on or after 1 January 2020.

### CBDT permits sharing of information by IT authorities with scheduled commercial banks

[Excerpts from The Economic Times, 1 September 2020]

Recently, notifications and memoranda of understanding have been issued for the exchange of information between income tax authorities and SEBI, CBIC, MSME, NCB, IB, NIA, Cabinet Secretariat, Ministry of Agriculture. Further, in this regard, the CBDT has recently permitted the sharing of information by income tax authorities with scheduled commercial banks listed in the Second Schedule of the Reserve Bank of India Act, 1934. Such information sharing is mainly to control tax evasion and widen the tax base in the country.

### 5% tax on foreign fund transfer from 1 October 2020

[Excerpts from LiveMint, 10 September 2020]

Starting from 1 October 2020, any amount sent abroad to buy foreign tour packages, and every other foreign remittance made above INR 7 lakh, will attract a tax-collected-at source (TCS) unless the tax is already deducted at source (TDS) on that amount. Tax on foreign tour packages will be 5% for any amount. For other remittances, the tax would be applicable only for the amount spent above INR 7 lakhs. Tax will be 0.5% for the education-related foreign remittances funded by loans (amount above INR 7 lakhs), considering many Indian students take loans to pursue education abroad. In the recent times, the Union finance ministry has been extending the scope of both TDS and TCS, and encouraging electronic payments in order to have a better idea of transactions in the Indian economy and take control over the spending patterns of taxpayers with their reported taxable income.

### IT dept launches functionality for banks to check refund filing status

[Excerpts from Business Standard, 2 September 2020

To ensure TDS, the Finance Act, 2020, with effect from 1 July 2020, amended the Income-tax Act, 1961, to lower the threshold of cash withdrawal to INR 20 lakh for TDS's applicability for non-filers. It also mandated TDS at a higher rate of 5% on cash withdrawal exceeding INR 1 crore by non-filers. The tax authorities said that the data on cash withdrawal helps to identify the individuals who have never filed the return of income but have withdrawn huge amounts of cash. In order to ensure return filing by these persons, it has launched a functionality for scheduled commercial banks to check the status of income tax returns filed by entities based on their PANs. Scheduled Commercial Banks are required to document and implement appropriate information security policies and procedures with clearly defined roles and responsibilities to ensure the security of information.

## Industry Insights

Tax Collection at Source (TCS) provisions are effective from 1 October 2020 and have wide reach and applicability. The Central Board of Direct Taxes also issued a Circular to address the impediments faced by taxpayers in implementing the TCS provisions. The issuance of the circular was imminent, considering the challenges amongst taxpayers around the subject. The circular elucidates several aspects including non-adjustment of GST component, discounts and sales return for calculating sales consideration amongst other aspects.

However, further clarity is required on the following issues:

1. Though it has been clarified in the Circular that TCS would be applicable where the invoice is issued before 1 October 2020 and payments are received after October 1, 2020, it remains unclear how TCS would be recovered from buyer when the same has not been shown as a separate line item on the face of the invoice. It is advisable to issue debit note for TCS amount and have clear understanding with buyer in this regard;
2. TCS is applicable @ 0.075% till 31 March 2021 and @ 0.10% thereafter. Again, it remains unclear how differential TCS would be recovered from buyer on sales consideration received on or after April 1, 2021 (for the invoices issued on or before 31 March 2021) when TCS has been shown @ 0.075% on the face of the invoice. It is advisable to include a condition in the invoice about recovery of differential TCS in the event of change in TCS rate and issuance of debit note for differential TCS amount;
3. Legally, modus operandi of TCS is 'collect & pay.' However, since TCS is a new tax, practically buyers are insisting to follow 'pay & collect' model wherein they will reimburse TCS to seller once it is reflected in their 26AS;
4. Whether TCS provisions would be applicable on deemed exports or not i.e., when goods are supplied to a special economic zone or a free trade warehousing zone;
5. Whether TCS provisions would be applicable on high sea sales or not i.e., if 'A' from India purchases from a foreign supplier and transfers the documents of title in the goods to 'B' before the goods cross the customs frontiers of India, 'B' is considered as the importer of goods and is required to file 'Bill of Entry' and clear goods on payment of customs duty. Whether 'A' is required to collect TCS from 'B'?;
6. In case the sales consideration is adjusted against the purchases from the same party, it is not clear as to how TCS provisions would apply. Ideally, TCS should be collected on gross receivable from the party.

The TCS rate has been kept low and buyer will eventually get the credit of TCS, hence, TCS is not a cost to the buyer. Therefore, it would be a prudent business practice to avoid taking any aggressive position to the extent possible and follow the TCS provision in law and spirit.

**Ravi Shingari**
**Group Head - Accounts and Taxation**
**Apollo Tyres Ltd**

## Transfer Pricing

### Revised Guidance Note on Report u/s 92E of the Income Tax Act, 1961 (Transfer Pricing) released by ICAI

Institute of Chartered Accountants of India (ICAI) has released the updated Guidance Note on report u/s 92E of the Income Tax Act, 1961 (Transfer Pricing), or 'the Act' in August 2020. The ICAI, through its Committee on International Taxation, has been issuing guidance for its members in respect of Report under Section 92E of the Act. The publication was last revised in the year 2019. Keeping in view the changes brought by the Finance Act 2020, ICAI has now released the Eight Edition of the Guidance Note.

Some of the salient amendments incorporated in the revised Guidance Note are listed below:

- Amendments to Chapter 3 – Associated Enterprise to include source and deemed definitions, the relationship between Head Office and Branch Office and associated enterprises in relation to specified domestic transactions;
- Amendments to Chapter 4 – International Transactions to include capital financing transactions, cost contribution arrangements, and free of cost services;
- Amendments to Chapter 5 – Arm's Length Price to include the distinctive nature of the property/services, analysis on the functions, assets and risks, characterization, tested party, contractual terms and market conditions;
- Amendments to Chapter 7 – Documentation and Verification to include ownership, profile and business of the taxpayer;
- Extension of the provision of Safe Harbour Rules for AY 2020-21;
- Amendment in section 92F wherein the due date for filing Form 3CEB is one month prior to filing return of income. The due date for filing Form 3CEB has been explained to be 31 October of the assessment year;
- Amendment to Section 92CE giving clarification with regard to the applicability of the provision of secondary adjustment and the option to make a one-time payment by the taxpayer;
- Option to the taxpayer to appoint joint auditors for carrying out a transfer pricing audit. Auditing Standard 299 – Joint Audit of Financial Statements to apply in such cases;
- The accountant is well advised to refer to Standards on Auditing as well as the guidance notes issued by ICAI while conducting the transfer pricing audit.

All the amendments made up to Finance Act 2020 have been incorporated in the 8th Edition of the Guidance Note. ICAI has acknowledged the challenges involved in reporting and disclosure of international transactions in light of the COVID-19 pandemic. Further, an insight provided on intricate issues will prove to be immensely useful and beneficial for all stakeholders while discharging the reporting requirements of Section 92E of the Act.

### Interpretation on the 60-day time limit for issuing transfer pricing order by the TPO

Under Indian Transfer Pricing Regulations, the time limit for issuing transfer pricing order by the TPO u/s 92CA(3A), falls any time before **60 days prior** to the date of completion of assessment proceedings u/s 153. Madras HC has recently allowed a batch of writs filed by taxpayers, quashing time-barred TPO orders passed beyond the 60-day time limit relevant for completing assessment proceedings for AY 2016-17.

As seen from the below table, the time limit for issuing TP order falls anytime 'before' 60 days 'prior to' to the date on which the time limit u/s153 expires, i.e., 31 December 2019. Accordingly, working backward, the 60th day prior to 31 December 2019 falls on 1 November 2019 (counting 30 days in both November and December). Therefore, the time limit for passing the TP order should be at any time before 1 November 2019, i.e., on or before 31 October 2019. The HC held, that TPO order passed on 1 November 2019 was time-barred and thus quashed.

Under Indian Income Tax Law, assessments framed after the statutory time limit are held to be invalid. Therefore, the correct interpretation of the time limits given in the law is of utmost importance. Based on the above interpretation laid down by HC, the following dates are applicable for passing TPO orders u/s 92CA (3A) read with section 153 –

| Financial Year (FY) | Assessment Year (AY) | The time limit for completion of assessment proceedings u/s 153 when reference made u/s 92CA | The time limit for passing TP Order u/s 92CA (3A) |
|---|---|---|---|
| FY 2015-16 | AY 2016-17 | 33 months from the end of AY, i.e., 31 December 2019 | On or before 31 October 2019 |
| FY 2016-17 | AY 2017-18 | 33 months from the end of AY, i.e., 31 December 2020 | On or before 31 October 2020 |
| FY 2017-18 | AY 2018-19 | 30 months from the end of AY, i.e., 30 September 2021 | On or before 31 July 2021 |
| FY 2018-19 | AY 2019-20 | 24 months from the end of AY, i.e., 31 March 2022 | On or before 30 January 2022 |

## Indirect Tax

### Invoicing time limit extended for goods taken outside India for sale on approval basis

[Notification No. 66/2020 dated 21 September 2020]

Section 31(7) of the CGST Act requires the supplier of goods to issue its invoice when the supply takes place, or within six months of the date of removal, in case of goods sent or taken on approval for sale or return. Now, the government has notified that any compliance under this section which falls during the period from 20 March 2020 to 30 October 2020 and is pertaining to goods sent or taken on sale on approval basis to a place outside India, the time limit for compliance shall be extended up to 31 October 2020.

### Government issues FAQs on e-invoicing mechanism applicable from 1 October 2020

The government has issued FAQs on the e-invoicing mechanism applicable to address the common concerns/queries raised by the industry. Some of the key clarifications issued are as follows:

- Entities with an aggregated turnover of less than INR 500 crores are not allowed/enabled to undertake e-invoicing on a voluntary basis;
- The ERP or accounting systems used by large taxpayers can be designed in such a way that they can report invoices in bulk to Invoice Registration Portal (IRP);
- After reporting invoice details to IRP and receipt of IRN, at the time of issuing an invoice to the receiver (e.g., generating as PDF and printing a paper copy or forwarding via e-mail, etc.), any further customization, i.e., insertion of the company logo, additional text, etc., can be made by respective ERP/billing/accounting software providers;
- At present, there is no separate placeholder for mentioning TCS under the Income Tax Act, 1961, collected by the suppliers. However, as a workaround, the field of 'Other Charges (Invoice Level)' can be used to mention TCS, where it doesn't form part of taxable value;
- For items outside the GST levy, a separate invoice may be given by such businesses;
- Printing of Invoice Reference Number (IRN) on the invoice is optional. IRN is anyway embedded in the QR Code to be printed on the invoice;
- The QR code (containing, inter alia, the IRN), which comes as part of signed JSON from IRP, shall be extracted and printed on the invoice. However, the printing of QR code on a separate paper is not allowed;
- Amendments are not possible on IRP. Any changes in the invoice details reported to IRP can be carried out on the GST portal (while filing GSTR-1). In case GSTR1 has already been filed, then the amendment should be made using the usual mechanism provided under the GST law.

# Tax Talk

## Global Developments

### Direct Tax

#### Sweden proposes new 'risk tax' for banks

[Excerpts from Reuters and Sveriges Radio]

The introduction of a special bank tax has been previously discussed. A bill was footed this month, to raise funds in the event of another financial crisis. Risk Tax, expected to come into effect in 2022, is aimed to strengthen public finances and create space to cover the costs that a crisis in the financial system entails. The proposal is expected to increase tax revenues by approximately USD 568 million in 2022. Foreign banks active in Sweden shall not fall outside the ambit of such tax. The proposal also suggests amendments and additions to the Foreign Tax Credit provisions in case the foreign tax has been paid within the group to another state within the European Economic Area.

Risk Tax has been introduced for larger banks and credit institutions with debts exceeding a specified threshold. The tax rate is set at 0.06% of a certain tax basis for financial years commencing on or after 1 January 2022 and is suggested to increase to 0.07% for financial years commencing on or after 1 January 2023. According to the proposal, the provisions shall enter into force as of 1 January 2022 and be effective on financial years commencing on or after 1 January 2022.

Risk Task has been assessed to affect 21 credit institutions representing 9 different groups.

#### The Netherlands looks to close more tax loopholes for multinationals

[Excerpts from the New York Times]

In 2017, the Netherlands ranked fourth worldwide in the amount of foreign direct investment into the country. Aggressive planning strategies allow big multinationals, like Google and Ikea, to move global profits through Dutch subsidiaries and drastically lower tax payments. The Finance Ministry submitted a proposal to the Parliament aimed at shutting down benefits that made the Netherlands a magnet for international corporations like Netflix, Nike and Uber. The Netherlands plans to levy a tax on profits transferred to tax havens and mend inconsistent national laws, which allow corporations to take the same deduction twice.

The new rule would prevent multinational firms from deducting foreign losses in the Netherlands as a way to pay little or no tax there. Multinationals with Dutch entities could see an end to several more loopholes with the government's multi-year efforts to clamp down on corporate tax avoidance.

### Japan mulls reforms to lure foreign financial firms

[Excerpts from Taipei Times]

In annual policy guidelines, the Financial Services Agency considers tax reforms to improve the country's standing as a global financial center. Tokyo ranked 3rd in Z/Yen Group's rankings of global financial centers published in March. While Japan has sought foreign professionals for years, issues of relatively high tax rates and lack of English-language fluency in the workplace have to be tackled. Japan comprehensively considered concrete ways akin to human resources development, tax reform, and budgetary measures.

Japan has raised the sales tax as part of efforts to rein in the country's huge debt, which, at twice the size of its economy, is the biggest among major advanced economies. Raising sales tax to 10% from 8% in October last year pushed Japan's economy into recession, even before COVID-19 hammered consumption and exports this year. The sales tax is a source of revenue to pay for Japan's social welfare burden.

### The debt-equity bias – European Union

[Excerpts from Law 360]

European Union is contemplating the examination of the distinctness of treatment of debt and equity for withholding tax relief purposes. A draft of the European Capital Markets Union action plan highlighted the need to prevent explicit or implicit barriers to cross-border investment within the European Union.

The returns on investment are taxed in both, the countries of investment and the investor. The reimbursement of taxes is a lengthy and costly process and often presents as an obstacle.

The EU may adopt a common, standardized, EU-wide system for withholding tax relief at source in order to lower costs for cross-border investors and prevent tax fraud and is expected to put forward a legislative initiative by Q4 2022.

## Transfer Pricing

### Frequently Asked Questions released by North Carolina Department of Revenue for the speedy redressal of taxpayers issues concerning inter-company pricing

An initiative, i.e., 'Transfer Pricing Resolution Initiative,' for the speedy redressal of issues concerning inter-company pricing, was introduced by the Revenue Department of North Carolina (hereinafter referred to as the 'Department' or 'Revenue') in August 2020. Further, in order to simplify the understanding and interpretation of the said initiative, the Department released a set of Frequently Asked Questions (FAQs).

The program is voluntary in nature, and the participants have to fill in a form and submit to the Department or the Auditor if they are undergoing an audit to participate in the scheme. The following are some key highlights of the program:

- The scheme will be effective from August 2020 to December 2020 only. No further extensions are expected;
- Being a voluntary scheme, taxpayers willing to participate will have to submit the documents relating to transfer pricing, financial data, tax information to the Department by 15 October 2020;
- The taxpayers undergoing an audit, as well as those under review, will be eligible to participate. Further, taxpayers who believe that the transfer pricing policy adopted by them is strong enough and does not need any adjustment also can participate in confirming the same;
- The routine statutory procedures will take place for the taxpayers under audit or review if there is no mutual agreement derived post-implementation of the scheme guidelines;
- The taxpayers will lose their right to appeal if they reach an agreement with the Department at the end of this scheme. However, if the decision is otherwise not acceptable to the taxpayer and there is no mutual consent, the right to appeal is retained;
- In order to derive a settlement agreement, the revenue may take the assistance of external consultants. The settlement agreement will clearly mention the due date of payment of the balances;
- The objective of the scheme is to settle all the issues of the corporates. Nevertheless, in some cases, the Department may settle the transfer pricing issues, only allowing the other issues to be in the ambit of the routine statutory processes

#### Our Comments

By introducing this initiative, the Department has attempted to settle maximum possible transfer pricing issues within a given time frame and created a win-win situation for the taxpayer and the department, both in terms of time and revenue.

This exercise will prove helpful for an early collection of revenue. However, if there is a mutual disagreement between the Department and the taxpayers, it might result in unproductive consumption of time and effort.

### Inland Revenue Authority of Services (hereinafter referred to as 'IRAS' or 'Revenue'), Singapore releases TP Guidelines in light of the ongoing pandemic of COVID-19.

The COVID-19 pandemic has resulted in a worldwide disruption of business operations leading to loss situations in the majority of the businesses. The IRAS has provided certain guidelines on transfer pricing requirements to be fulfilled by the businesses so as to avoid litigations in the times to come.

The guidelines predominantly elaborate on the difficulties that might be faced by the business in preparing the documentation, the need, and the base for term testing, APA arrangements, etc. The key takeaways from the guidelines are as follows:

#### TP Documentation

In light of the potential COVID-19 impact, companies are advised to provide additional qualitative information in their transfer pricing documentation to substantiate the arm's length nature of their transfer pricing outcome. The list of additional qualitative details include:

- Effect of COVID-19 on the industry and the impact on the taxpayer;
- Decision-making authority for the management of risks related to COVID-19;
- Comparative functional analysis of before and after COVID-19;
- Highlight whether related-party arrangements have been modified in light of COVID-19;
- Comparison of budgeted results versus actual results and an explanation of any key variances due to COVID-19 (with supporting evidence);
- Justification of the negative impact of COVID-19 on the profitability with explanations and evidence;
- Specify if there has been any COVID-19 specific government assistance received or any impact of government regulations imposed on the operations.

#### Term Testing

Taxpayers were required to consult the IRAS before applying term testing (combining multiple-year financial results as against annual results). In light of the potential impact of COVID-19, taxpayers are advised that they need not consult the IRAS for application of term testing if the annual testing may result in volatile results due to the impact of COVID-19. This has been suggested with the following key points:

- The rationale for the usage of term testing is to be substantiated with evidence that would complement the other documentation (as per points mentioned under Transfer Pricing Documentation);
- Explain clearly how the term-testing was applied;
- Highlight that this is a once-off event for the Year of Assessment 2021;
- Consider the corresponding impact of this approach on related parties in other jurisdictions.

#### Advance Pricing Agreement (APA)

**New APA Applications**

Even during COVID-19, the taxpayer may file for a new APA application.

**APA Applications in Progress**

The taxpayer should assess whether there are any transfer pricing implications arising from COVID-19, which may impact the APA application (such as - changes in the functional profile of the covered entities). If so, the taxpayer is encouraged to provide the relevant details to IRAS as soon as possible.

**Existing APA agreement with IRAS in light of COVID-19**

The taxpayer should review and assess whether there is any breach of the terms and conditions in the existing APA agreement. In the event there is such a breach in the critical assumptions, they should notify IRAS as soon as possible:

- providing an analysis of the impact as a result of COVID-19;
- explain why the terms and conditions have been breached;
- suggest the next course of action.

**Renewal of Existing APA**

Where there is an existing APA that covers the COVID-19 period, the taxpayer should evaluate if the business operations and economic performance are not significantly impacted by COVID-19. In case of any significant impact, the taxpayer may choose to consider filing a new APA application rather than a renewal. In the event of doubt, it is suggested to approach the IRAS for an early discussion.

#### Our Comments

MNEs need to chart out their path for aligning transfer pricing considerations arising from this unprecedented and exceptional COVID-19 situation. An integrated approach that covers group-level as well as country-specific assessments, will effectively facilitate this process. The transfer pricing impact of such assessment and re-alignment in the transfer pricing structure should be documented, which is reinforced with the IRAS guidance.

The IRAS has provided relevant guidance regarding transfer pricing documentation in the COVID-19 scenario. We can expect other jurisdictions to follow suit in due course. It is in the interest of MNEs to be proactive and start collating relevant quantitative as well as qualitative points that can assist in justifying any changes in transfer prices/re-alignment in FAR, etc. in their transfer pricing documentation.

### Taiwan Ministry of Finance (MOF) introduced a draft amendment to TP rules based on BEPS Action Plans 8-10

The MOF released guidelines which emphasize on the actual risks assumed and intangible assets employed by the business. The focus of this amendment is the disclosure of step-by-step risk analysis, the alignment of functional analysis of intangible assets with profit attribution, and the application of a lower threshold penalty for a failure to disclose.

BEPS Action Plans 8-10's Final Report: Aligning Transfer Pricing Outcomes with Value Creation, and on the 2017 amendment on Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations form the pillars of this amendment.

As per the guidelines, it is essential to analyze the risks assumed by the associated enterprises in a step-by-step manner, which includes:

i. Identification of significant risks;

ii. Determination of the risks assumed by different AEs;

iii. Determination of the roles of the associated enterprises in relation to the assumption and management of risks along with the functions of controlling the risks;

iv. Analysis of the consistency between the contractual terms and risks assumed by each AE along with the financial capacity of the entity to bear the risks;

v. Re-allocation of the risks based on the actual delineation of the transaction in order to provide appropriate rewards to the actual risk-bearing entity.

It is observed that an emphasis has been laid on the actual risks assumed by the party and its capacity to manage the risks. Tax authorities are to conduct audits using this approach after the amendment takes effect. Therefore, it is recommended that companies re-evaluate which related party can control and mitigate risks based on the actual conduct of the parties in order to be consistent with the contractual agreements.

Further, the guidelines also provide a clearer delineation of the definition of intangibles, intangibles-related functions, and risks, as well as an analysis involving the use of intangibles. The amendment says that the returns for the use of intangibles should be in harmony with the analysis conducted with respect to the assets used, functions performed, and risks assumed in connection with the development, enhancement, maintenance, protection, and exploitation (DEMPE) of intangibles.

#### Our Comments

The taxpayers should pay acute attention to the delineation of the risks and the intangibles as it is anticipated that the tax authorities may deep dive into the actual facts and figures related to the same. Further, all the contractual arrangements should be reviewed by the businesses to be consistent with the actual conduct to avoid litigations.

### New Zealand's Inland Revenue releases COVID-19 Guidance for Transfer Pricing highlighting the importance of documentation

The COVID-19 pandemic has created exceptional economic circumstances with significant uncertainty remaining over the depth and duration of its effects. The impact on specific sectors and businesses has varied substantially, ranging from severe revenue reductions to abnormal profits for some industries.

The guidelines state that in spite of the practical difficulties arising due to the widespread pandemic, the arm's length principle still remains applicable. A contemporaneous documentation elaborating on the specific facts and circumstances faced by the business assumes critical importance during the pandemic. The following points are highlighted for the documentation:

- Identification and collection of evidence to support the nature, duration, and extent of the impact on the business due to COVID-19;
- Documentation of any changes in the local and group functions, assets, and risks along with actions taken by different group entities in response to the effects of the pandemic;
- Identify any changes in the intra-group transactions, contractual terms, and intra-group transfer prices and recording of the rationale for the said changes;
- Analyze and record the overall impact of COVID-19 on the overall profitability of the group.

The arm's length principle should be applied and supported by quantifying the financial impacts and their reasons like causes for the reduction in revenues coupled with an increase in expenses, adjustments made, assistance availed, etc.

#### Our Comments

The above amendments portray the constant focus of the tax authorities worldwide on a contemporaneous, in detail, and effective documentation which will enable the taxpayers to be in a good position to justify the arm's length nature of inter-company transactions not only in the times of a pandemic like COVID-19 but also in regular circumstances.

### Do the tax authorities have a right to re-characterize the transactions of the taxpayers to prove a motive of tax avoidance?[ Finland Supreme Court Ruling on re-characterization of an international transaction- Case No: KHO : 2020:35]

#### Facts of the case

The said case has been vindicated by the Supreme Court of Administration (SAC) of Finland.

The taxpayer is a parent company of the group which conducts machinery and equipment rental business in various countries through its subsidiaries. As a per re-organization arrangement within the group, a separate entity was established in Belgium to handle the intra-group finances (hereinafter referred to as NV). All the intra-group loans receivable along with their interest income as on date were transferred to NV for which, the parent entity received shares of the NV as consideration. Further, functions, risks and assets were partially shared by the entities post formation of the NV.

As per the contractual arrangement between the entities, the NV is guaranteed with a Return on Equity (ROE) in accordance with TNMM and the parent company receives the balance return, if any. A target limit was also set between the two entities for the allocation of the returns.

NV analyses the repayment capacity of the group entities after receiving a request from them and sets the terms and conditions of the loans individually. The loan being given is in the local currency of the borrower; interest is also decided as the local IBOR rate plus a margin.

The Administrative Court (AC) had alleged that NV is providing support services to the parent company since the decision-making power rests with the parent company and made a TP adjustment. It also rendered the transaction as a means of tax avoidance.

#### SAC held as under

While rendering the allegation of the AC as erroneous, the SAC stated that the AC had not taken into consideration the re-organization of the group's internal financing and the equity investment provided by NV. Further, ignoring the fact that NV has the decision-making powers related to the loans and it is a party to all the loan contracts, the AC reclassified the two-way hedging agreement as a service agreement with a completely different operating model and outcome.

Referring to the OECD guidelines, SAC observed that the revenue authorities must identify the actual transaction carried out by the taxpayer before considering a re-classification. Further, it stated that the actual transactions should not be disregarded or replaced with other transactions unless there are exceptional circumstances.

In light of the above facts, SAC annulled the decisions of the lower authorities and deleted the adjustment.

#### Our Comments

The above-mentioned case focuses on the substance of the transaction rather than its legal form. Further, it is pertinent to note that the actual delineation of the transaction is of utmost importance while analyzing any related party arrangement.

GAAR can be invoked only if the taxpayer is unable to prove that the form of the transaction corresponds to its substance and the obvious purpose of the transaction was not tax avoidance.

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## Indirect Tax

### UK extends VAT cut applicable to the hospitality sector

The Chancellor of the Exchequer, Rishi Sunak, has announced that the temporary VAT cut from 20% to 5% applicable to the hospitality sector would be extended till 31 March 2021. Earlier, the benefit of the said VAT cut was to be made applicable only till 12 January 2021. The Chancellor, in his statement, said that the move is expected to protect around 2.4 million jobs through the winter in the UK, which like most other major economies, has been severely affected by the COVID-19 pandemic.

# Compliance Calendar

Direct Tax | Transfer Pricing

### 7 October 2020

- Payment of TDS and TCS deducted/collected in September 2020
- Payment of Equalisation Levy by Non-resident E-commerce operator for the period July to September 2020
- Payment of Equalisation Levy on payment made by a resident to a non-resident for online advertising and related services

### 15 October 2020

Filing of TCS statement for the period from July to September 2020

### 30 October 2020

- Issuance of TCS Certificates (Form 27D) for TCS collected for the period July to September 2020
- Due date for furnishing of challan-cum-statement in respect of tax deducted under section 194-IA for the month of September 2020
- Due date for furnishing of challan-cum-statement in respect of tax deducted under section 194-IB for the month of September 2020

### 31 October 2020

- Filing of TDS Statements for the period July to September 2020
- Filing of annual information with the Department of Scientific and Industrial Research (DSIR) for approved R&D facilities, for cases where transfer pricing provisions are not applicable
- Due date for filing audit report under section 44AB for the Assessment Year (AY) 2020-21.
- Due date for filing the Accountants report in form 3CEB for the AY 2020-21

### 31 October 2020

- Transfer Pricing Audit and certification -Form 3CEB for FY 2019-20
- Maintenance of transfer pricing documentation FY 2019-20
- Master file - Form 3CEAB - Designating the entity
- Indian Company of an international group - Intimation of CbCR Accounting year (assuming global reporting accounting year is 1 January 2019 to 31 December 2019)

***Notes***

However, it must be noted that in September 2020, the Taxation and Other Laws (Relaxation of Certain Provisions) Bill, 2020 was passed in Parliament to incorporate the effect of Taxation and Other Laws (Relaxation of Certain Provisions) Ordinance, 2020 dated 31 March 2020 read with the notification dated 24 June 2020. The said bill has extended all respective due dates, falling during the period from 20 March 2020 to 31 December 2020, **except the ones mentioned below till 31 March 2021.**

- Due date for filing of return of income for non-corporate assessees who are not required to be audited for the financial year 2019-20, is extended to 30 November 2020
- Due date for filing the audit report for AY 2020-21 is extended to 31 October 2020.
- Due date for filing the accountants report in Form 3CEB for AY 2020-21 would remain 31 October 2020.

The benefit of the extended due date shall not be available in respect of payment of taxes (including equalization levy). However, any delay in payment of tax, which is due for payment from 20 March 2020 to 31 December 2020, shall attract interest at the lower rate of 0.75% for every month or part thereof if the same is paid after the due date but on or before 31 December 2020.

# Compliance Calendar

Indirect Tax

**10 October 2020**

- GSTR-7 for the month of September 2020 to be filed by taxpayer liable for Tax Deducted at Source (TDS)
- GSTR-8 for the month of September 2020 to be filed by taxpayer liable for Tax Collected at Source (TCS)

**11 October 2020**

GSTR-1 for the month of September 2020 to be filed by registered taxpayers with an annual aggregate turnover of more than INR 15 million

**13 October 2020**

GSTR-6 for the month of September 2020 to be filed by Input Service Distributor (ISD)

**20 October 2020**

- GSTR-5A for the month of September 2020 to be filed by Non-Resident Online Database Access and Retrieval services (OIDAR)
- GSTR-5 for the month of September 2020 to be filed by Non-Resident Taxpayers (NRTP)
- GSTR-3B for the month of September 2020 to be filed by all registered taxpayers having turnover of more than INR 50 million in the previous financial year

**22 October 2020**

GSTR-3B for the month of September 2020 to be filed by all registered taxpayers having turnover of up to INR 50 million in the previous financial year and located in the Category A states

**24 October 2020**

GSTR-3B for the month of September 2020 to be filed by all registered taxpayers having turnover of up to INR 50 million in the previous financial year and located in Category B states

**25 October 2020**

ITC-04 for the period of July 2020 to September 2020 in respect of goods dispatched to a job worker or received from a job worker

**31 October 2020**

GSTR-1 for the quarter of July 2020 to September 2020 to be filed by registered taxpayers with an annual aggregate turnover of up to INR 15 million

***Notes***

Category A states - Chhattisgarh, Madhya Pradesh, Gujarat, Maharashtra, Karnataka, Goa, Kerala, Tamil Nadu, Telangana or Andhra Pradesh or the Union territories of Daman and Diu and Dadra and Nagar Haveli, Puducherry, Andaman and Nicobar Islands and Lakshadweep.

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

Events

News & Insights

## News

### Will credit availability fall with additional fields in GSTR 2A? Check how it may affect you

**Financial Express**

Read Here https://bit.ly/36L8mFD

## Alerts

Direct Tax

### Scaling up the Start-up Ecosystem – Recommendations of Standing Committee on Finance

**22 September 2020**

Read Here https://bit.ly/3jJPMl8

Transfer Pricing

### Singapore IRAS issues guidance for Transfer Pricing on account of COVID-19

**18 September 2020**

Read Here https://bit.ly/2IfEHKR

### GST @3 + Foreign Remittance and Multilateral Instrument (MLI) Impact

**Organizer - VDMA**

3 September 2020

Watch it here https://bit.ly/33ljzF3

### Retrospective amendment to ESR in UAE

**Organizer - Nexdigm(SKP)**

14 September 2020

Watch it here https://bit.ly/3lqDRJb

### Faceless Assessment Scheme

**Organizer - Nexdigm(SKP)**

18 September 2020

Watch it here https://bit.ly/3nvET8O

## Upcoming Webinar

Tax Conference (2 Day)

**Organizer - CII**

15 - 16 October 2020

**Register Now**

# Easy Remittance Tool

**The Easy Remittance tool by Nexdigm (SKP) simplifies the mandatory compliance procedure for foreign remittances by automation of Form 15 CB certifications. Through its simple retrieval mechanism for documents and reduced turn around time, the tool has helped us serve large corporates with numerous foreign remittances, enabling our clients to maintain the right tax position, at all times.**

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Ability to upload Form 15 CA on the same platform

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# About Nexdigm (SKP)

Nexdigm (SKP) is a multidisciplinary group that helps global organizations 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.

Our cross-functional 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.

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

Our team provides you with solutions for tomorrow; we help you *Think Next*.

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