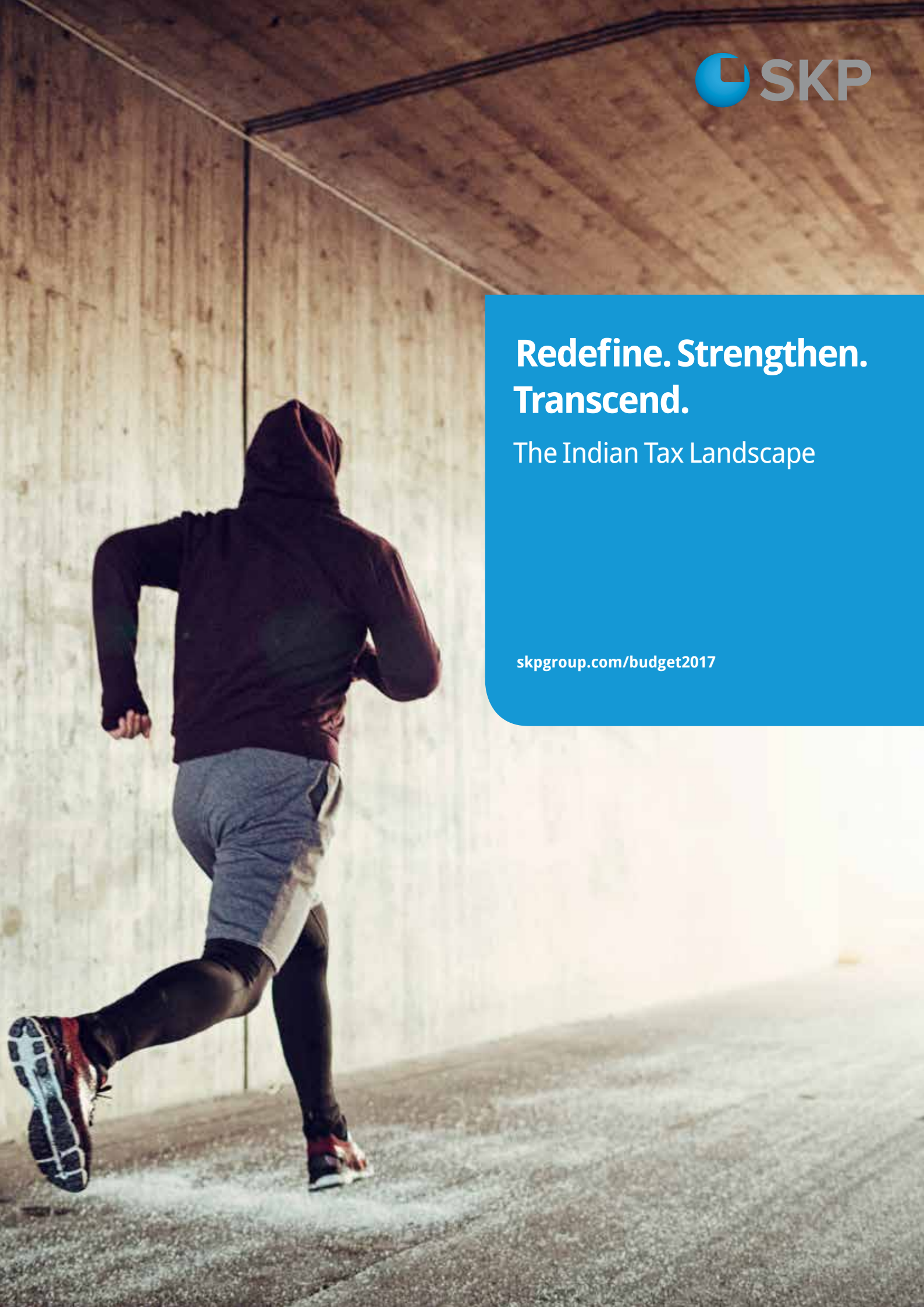


Redefine. Strengthen. Transcend.

The Indian Tax Landscape

skpgroup.com/budget2017



Base Erosion and Profit Shifting (BEPS)
p7



Transitioning to GST
p5



Role of Technology
p9



Changing Compliance Landscape
p3



Pending Litigation and its Impact on Business
p11



Changing Litigation Landscape in India
p1



Significant Rulings and its Impact on Tax Positions
p13

Table of contents



CHANGING LITIGATION LANDSCAPE IN INDIA

FROM PENDING LITIGATION TO SPEEDY RESOLUTIONS

“Next to being shot at and missed, nothing is really quite as satisfying as an income tax refund“

India is moving at a rapid pace on the path of economic growth, and its litigation landscape is keeping up.

Over the years, taxpayers from different sectors have experienced various reactions on matters under litigation with the Indian Tax Authorities. However, this scenario could soon change as the government is making sincere efforts to bring in efficiency and speed in the disposal of matters under litigation.

The government is working towards a ‘litigation-by-exception’ tax regime, and has taken some landmark steps towards reducing tax litigation. Two specific examples of this approach are the introduction of Limited Scrutiny Assessment (Revenue Audit) and a substantial modification in the criteria for the initiation of transfer pricing assessment.

Under a Limited Scrutiny Assessment, as the name suggests, the scope of the Tax Authorities’ enquiry is limited to the ‘reason for selection’ of scrutiny and does not involve calling for extremely detailed information and making fishing enquiries about different items in the financial statements. During the first round of litigation under the Limited Scrutiny Assessment regime, it was disheartening to see that the Limited Scrutiny Assessments have remained ‘Limited’ in its spirit.

Similarly, the criteria for initiating a transfer pricing assessment were revised with a specific focus on a risk-based approach as against a blanket monetary threshold approach. Under the revised criteria, only those cases which have apparent transfer pricing risks (as identified by a computer system) or where transfer pricing adjustments of more than INR 100 million have been made in the past, will be selected for a transfer pricing scrutiny in isolation. In all other cases, transfer pricing scrutiny shall not be initiated. In such cases, the government, perhaps pre-empting the approach of the tax officers, has expressly prohibited the tax officers to look at transfer pricing matters even if the case is selected for a scrutiny assessment due to any other reason.

Another encouraging trend is a substantial reduction in the number of cases being selected for scrutiny. The tax departments have also made suitable changes to the monetary limits below which appeals shall not be filed by the tax authorities. Further, the government has now proposed to reduce the time limit for completing scrutiny assessments to 12 months in a phased manner.

This approach has not only reduced the taxpayers’ burden particularly for those who are involved in assessment proceedings all round the year, thus entailing substantial time and costs, but this approach has also allowed the tax officials to conduct a more qualitative scrutiny of items of greater impact

The Advance Pricing Agreement (APA) programme introduced in 2012 has invoked a considerable positive response from taxpayers. The APA is considered to be an effective controversy management tool, which helps reduce time and monetary costs of litigation for taxpayers. The on-ground feedback from taxpayers and tax professionals is that the APA authorities are fair and transparent in their dealing and make an active effort to understand the business dynamics of the taxpayers. In the current financial year (with 2 months still to go), India has signed 53 APAs, which work out to more than 1 APA per week! Comparing this to global standards, the speed of completion of an APA in India is fascinating.

The effectiveness of the Dispute Resolution Panel (DRP) remains a concern with many taxpayers viewing the DRP to be the ‘faster route to the tribunal’.

Prime Minister Modi's mantra of 'Good Governance' is also taking shape on the ground with a remarkable shift in the approach of the tax officials who are now more courteous and inclusive in their approach from the Tax Authorities. The tax officials are seen adopting more rational positions rather than following a singular approach of basing their acts on their predecessors. The Revenue Boards have also issued letters to their staff underlying the expectation of the government that the Tax Officers should be sensitive in discharging their duties based on the sound principles of law which can stand the scrutiny of a higher forum rather than passing pro-revenue and frivolous orders, to avoid unnecessary litigation. There has also been a relatively quick disposal of rectification and refund applications involving a substantially large amount.

The government has issued numerous circulars and answers to Frequently Asked Questions (FAQ) over the past few months to clarify interpretations of different provisions of the tax laws. FAQs were issued from time to time to clarify the application of the Income Declaration Schemes. The Place of Effective Management (POEM) regulations were also supported by detailed guiding principles with express clarification on the government's intentions. A similar approach was taken for the issuance of FAQs dealing with General Anti-Avoidance Rules (GAAR).

The government is trying increase the use of technology thereby reducing the touch-points between the taxpayer and tax authorities. Some cases in point are an introduction of the electronic assessment system by the Income-tax Department as a Pilot Project and 'Computerised Desk Audit' by the Maharashtra VAT department. Under these initiatives, the entire assessment proceeding is conducted electronically without having to make multiple rounds of the tax offices and demonstrates the changing outlook of tax administrators.

Another remarkable development, aided largely by a dynamic judiciary, is the speed of the disposal of cases before the appellate authorities. While litigation remains inevitable in any tax environment, the pace of the disposal of cases before the judicial forums also contributes towards providing the necessary guidance to the taxpayers and tax administrators. Contemporary issues such as marketing intangibles and advertising marketing and promotion spend, location savings, selection of tested party, etc. have reached the higher courts and we are expecting to see these issues nearing a settlement at least at judicial levels in the near future.

At the international forum, India is making rapid advancements in resolving tax disputes. Almost 100 plus Mutual Agreement Procedures (MAP) cases (42 cases on



treaty interpretation issues and 66 cases on transfer pricing issues) were recently resolved between India and the USA. Similarly, the revised double taxation avoidance agreement (DTAA) between India and Singapore facilitates negotiation of Bilateral APA and also opens a window to resolve tax issues through MAP.

While there are numerous positives basis the developments in the last one year, certain old issues remain. The effectiveness of the Dispute Resolution Panel (DRP) remains a concern with many taxpayers viewing the DRP to be the 'faster route to the tribunal'. The pendency of cases before the first appellate authority (CIT (appeals)) and the time of disposal of appeals does not show signs of improvement. The cases relating to capital gains tax on the indirect transfer of shares issue led by Vodafone continue to remain open without any amicable resolution in sight. It almost seems to have become a point-of-no-return for the parties involved with Vodafone declining to apply under the settlement scheme initiated by the government.

While the government has clarified its intent of developing a stable tax regime, the results of many of the government's initiatives will require a mindset change on the part of the tax administrators and as well as taxpayers. If the mindset of the people in the tax environment keeps pace with the government's initiatives, the proverbial '*acche din*' (good days) will not be far away. Ultimately, a responsive and fair tax administration encourages tax compliances far more than any incentives or penalties that the law may bring about!



CHANGING COMPLIANCE LANDSCAPE

TOWARDS A WIDER TAX NET

Tax compliance is “taxation by confession”

On 31 December 2016, Prime Minister Narendra Modi shared a statistic that sparked curiosity amongst many – only 2.4 million people in India report a taxable income of more than INR 1 million. This revelation resulted in a series of newspapers quoting reports pointing to income indicators. For example, 2.5 million luxury cars are sold in India every year.

In his budget speech of 2017, the Finance Minister also shared similar statistics. For instance, out of 1.39 million companies in India, only 0.59 million companies have filed their tax returns for the year ending 31 March 2016. Out of 7.6 million individual taxpayers declaring income above INR 500,000, 5.6 million taxpayers belong to salaried class. Indicating the low level of tax compliance in India, The Finance Minister remarked that “*We are largely a non-tax compliant society*”.

This glaring disparity between the reported income and the perceived number of people in the high income group, in the Prime Minister’s own words, could invoke satirical laughter or anger! The Economic Survey of 2015-2016 observed that only 5.5% of earning individuals form a part of the tax net.

While the government has shared such statistics to draw attention to the extent the menace of *black money* and tax evaders go, it has also been subtly widening the tax net to facilitate the identification of tax evaders. This has been broadly done by expanding the scope of compliances, increasing the use of technology for faster processing of compliance data, interlinking data between different divisions of the government and initiating punitive actions against non-compliance. The government has also proposed to introduce a mandatory fee of INR 5,000/INR 10,000 for delay in filing of income-tax returns.

The government has expressly stated its intentions to simplify tax laws through a reduction in tax rates along with the removal of tax exemptions. The government seeks to maintain its revenue base by increasing the tax compliance net.

Accordingly, over a period of time, the government introduced certain compliance mechanisms which help gather relevant information in this regard. The government is increasingly relying on businesses to assist in collating and furnishing relevant information at regular intervals.

For instance, the Tax Deducted at Source (TDS or withholding tax) reporting regime has seen frequent modifications in recent years, each aimed at closing compliance gaps. The government has also launched a separate website to deal with TDS matters (TDS Centralised Processing Cell) and is focusing on electronic data processing and report generation. A mistake in TDS returns now results in a tax demand notice in a matter of few days!



The government has expressly stated its intentions to simplify tax laws through a reduction in tax rates along with the removal of tax exemptions.

The scope of reporting under the Annual Information Return (AIR) has been expanded and more transactions are now being reported to the government. For instance, cash sales in excess of INR 200,000 per transaction are now being reported to the government through AIR reporting as well as Tax Collection at Source statements. On similar lines, for receipts in cash in excess of INR 300,000 from a person either during a day or in relation to a transaction/event, the government has proposed to impose penalty equal to the amount received.

The Income-tax Return forms have also been modified to facilitate data-linking. Almost all taxpayers are required to file their tax returns electronically. For individuals, the passport number is also required to be quoted in the tax return, and there are reports stating that quoting an individual's 'Aadhaar' number will soon be mandatory.

The TDS credit and Value Added Tax (VAT) credit to be availed by a taxpayer is now linked to the data furnished by the tax deductor or the seller. This has compelled taxpayers to work with the government, though begrudgingly, to persuade business associates to ensure appropriate compliance reporting. This requirement will continue under the GST regime.

India Inc. is highly sceptical about the level of compliances that shall be required under the forthcoming GST regime. Given that the GST regime will require each and every transaction to be reported electronically on the common web-portal of the government (GST Network), the economic cost in creating suitable infrastructure for undertaking compliances could increase substantially. However, facilities like GST Suvidha Providers and GST Tax Return Preparers may mitigate this problem to a certain extent. Overall, given the magnitude of compliances under GST, the data inter-linkages between different players in the value-chain will require greater focus.

Taking a cue from the recent developments in this area, it seems that there will be significant compliance reporting requirements in the near future. Tax compliance is set to become, if it is not already, a critical business function for businesses. The socio-economic measures adopted by the government to make India a less-cash economy implies the requirement of a broader compliance and reporting framework.

The government is working towards making compliances simpler. For instance, the procedures for obtaining a Permanent Account Number (PAN) or a service tax registration has been considerably simplified. The Income-Tax Return utilities provide a pre-fill option where master data from earlier years can be filled at the click of a button. Certain archaic forms under the indirect tax laws are also being omitted.

A significant section of taxpayers do not undertake tax compliances, either due to genuine ignorance of the law or because they did not seek professional advice at the appropriate time. The level of tax compliance, particularly by the unorganised sector is also quite low. In certain cases, tax compliances are undertaken out of business persuasions or extraneous factors, such as securing bank loans or obtaining a passport, instead of its actual purpose. The government is focusing its efforts on bringing this section of the economy within the tax net.

Though the objective of the government to simplify compliance is clear, the initiative is more towards undertaking compliances electronically. Hence, although adhering to compliance needs may become simpler, the economic cost of undertaking compliances will definitely be substantial.



TRANSITIONING TO

GOODS AND SERVICES TAX (GST)

**“Count the day won when, turning on its axis,
this earth imposes no additional taxes“**

The introduction of Goods and Services Tax (GST) in India has evoked an unprecedented range of emotions such as excitement about the concept, curiosity about its impact on business, uncertainty about its effective date, apprehension about the manner of implementation and increased eagerness about the legal and political manoeuvres to transition to the GST regime.

Currently, through multiple rounds of discussions between the Central government, state governments and all stakeholders, a number of prerequisites for GST have fallen in place. The government has, set post GST Council meeting of 16 January 2017, set 1 July 2017 as the target date of GST implementation.

While the Finance Minister did not specify a definitive way forward in his Union Budget speech, he stated that the preparation of Information Technology (IT) systems for GST is on schedule and that extensive efforts to reach-out to trade and industry will start from 1 April 2017. The Finance Minister also mentioned that the government shall continue to strive to achieve the goal of implementation of GST as per schedule without compromising the spirit of co-operative federalism.

GST, which will replace the existing indirect tax structure in India, is expected to be more of a business reform than a mere tax reform. The impact of GST will be felt in varying degrees across business functions such as procurement, manufacturing, distribution, logistics, planning, sales and marketing, accounts and finance, human resources, to name a few. The structural changes under GST will have a direct bearing on working capital requirements, service-level commitments as well as procurement and warehousing strategies. Above all, the GST impacts product/service costing and business margins. Hence, GST is rightly believed to be a 'Game Changer' for Indian businesses. Businesses therefore, will have to plan the transition to GST in a scientific manner after carefully considering its nuances.

For an effective transition to GST, every business function will need to be assigned with responsibilities, including identifying changes in the accounting process, fixing pricing

policies, ascertaining whether its vendors are GST compliant, restructuring of tax clauses in contracts and agreements. Credits disclosed in the existing statutory returns shall be carried forward in the GST regime if these credits are admissible under the new tax regime.

The following are some of the key activities that business houses should undertake for a smooth transition to GST:

Enrolment under GST

Taxpayers registered under any of the existing indirect tax laws namely, VAT, CST, excise or service tax would have to enroll and migrate their registrations for GST. This activity has already been initiated by the government.

Every business function will need to be assigned with responsibilities of the identification of changes in the accounting process, fixing of pricing policies, ascertain whether its vendors are GST compliant, restructuring of tax clauses in contracts and agreement, etc.

Revisiting ongoing contracts

All existing and ongoing contracts which may entail the delivery of service/goods post July 2017, i.e. post introduction of GST would have to be revisited to ensure that such contracts are duly aligned with GST. These contracts should have appropriate clauses for statutory variation to mitigate any adverse tax implications.

Interaction with key vendors/ customers

It would be imperative to ensure that vendors and customers are in sync with what needs to be done under GST. This will be one of the key parameters for evaluating the GST impact on costing and business margins.

It is also important to note that, in order to ensure everyone is benefited by GST, the draft GST law contains anti-profiteering provisions to ensure that GST related savings are passed on to the appropriate stakeholders in the value chain and that the Tax Authorities are empowered to impose penalties in case of non-compliance.

Tax Efficiency and Optimisation

The Proposed GST Law lays down transitional provisions. It is necessary to go through these provisions to identify opportunities to improve tax efficiency and to optimise on the benefits arising out of GST. Furthermore, the revised model GST law also assures a seamless flow of credits, thereby resulting in a commensurate reduction in price.

Therefore, it would be worthwhile to re-visit existing tax positions to explore tax planning opportunities and mitigate exposures, if any.

Revamp of Information Technology Systems

Existing Information Technology (IT) systems must be modified to make them GST compliant. Right from maintenance of masters such as tax masters, vendor masters, customer masters to the generation of invoices, booking of expenses and revenue, auto-determination of tax codes to the generation of various reports the IT systems will require due attention.

Getting ready for compliance

The proposed model GST Law calls for three monthly statements and an annual return as a minimum requirement per state (i.e. minimum 37 returns per state). It also speaks of input credit matching. In all likelihood, compliance requirements are set to rise. Therefore, systems should be in sync with the new tax regime to generate reports that would enable timely compliance.

Training

Training internal and external stakeholders would also be vital for the GST transition which will go a long way in ensuring that the effect of GST is correctly given and that compliances requirements are being met with appropriately.

Thus, business houses will have to devise appropriate strategies to move towards GST in a seamless manner. The changes required across business functions will need to move in tandem in order to ensure that the organisation as a whole is GST ready.





BASE EROSION AND PROFIT SHIFTING (BEPS)

THE BIGGEST INTERNATIONAL TAX REFORM IN THE PAST CENTURY?

“Income tax created more criminals than any other single act of the government”

In the last few years, media reports revealed that the effective tax rates of some leading Multinational Corporations (MNCs) are lower than 1% of their revenues. These reports sparked-off public protests and led to a surge of anger within the taxpayer community, who compared their own effective tax rates with those paid by the supposedly highly-profitable MNCs. It also made the common man wonder how this was achieved.

The answer to this question was the sophisticated tax planning practices of MNCs, of reducing their tax base by shifting profits to other countries especially tax havens (i.e. Base Erosion and Profit Shifting (BEPS)). This was being done within the existing legal framework by taking advantage of loopholes/gaps/mismatches in the tax rules of different countries.

Origin of the BEPS Project

In order to curb such *malafide* practices, the Organisation for Economic Cooperation and Development (OECD) along with G20 countries formulated the BEPS Action Project. This project aims at providing a mechanism to plug such loopholes/gaps/mismatches in international tax laws, thereby providing every country an opportunity to earn their fair share of tax revenues.

The BEPS Project has 15 Action Plans covering the taxability of digital economy, hybrid entities, prevention of treaty abuse, artificial avoidance of Permanent Establishment (PE), linking transfer pricing requirements to value creation, dispute resolution mechanisms, to name a few.

Underlying principles of the BEPS Project

The underlying principle of the BEPS Project is that tax should be paid in the country in which the economic substance and value-addition functions of a transaction are carried out and the tax treaty benefits should not be given to *dummy*/shell entities set up primarily to take unfair advantage of tax treaties and mis-match in tax rules.



Implementation of the BEPS Project

Implementing the BEPS Action Plan would require amending more than 3,000 bilateral tax treaties. Therefore, to save the participating countries the need to approach each of its treaty partners for the amendment of their bilateral tax treaty, Action Plan 15 of the BEPS Project provides for the signing of a Multi-Lateral Instrument (MLI) to modify various tax treaties simultaneously. Once signed, the MLI would have to be read along with the various bilateral tax treaties.

The MLI was issued in November 2016 and a signing ceremony is proposed to be held in June 2017 in Paris.

Minimum standards – a measure towards acceptance of BEPS principles

The MLI provides for certain minimum standards (binding clauses) i.e. clauses to be compulsory adopted by countries signing the MLI. These clauses are binding on all participating countries and cannot be deviated from. In addition, there are certain recommendatory (optional) clauses with alternative options regarding the text and coverage of optional clauses. Participating countries have the freedom to reject the optional clauses or to accept the alternative options as per their requirement. The MLI also contains provisions to deal with mismatches between decisions/options chosen by the participating countries.

India's support towards the BEPS Project

Since the BEPS Project aims to link tax with value creation, developing countries stand to gain from it. India has been one of the front-runners in the BEPS initiative.

It is said that the Indian tax authorities' position on certain tax matters, for which they were criticised in the past (for being narrow-minded and revenue-focused), now find place under the BEPS Action Plans.

The effect of BEPS on the Indian tax environment

At the outset, India has already introduced certain provisions in its domestic tax law to deal with concerns highlighted under the BEPS Action Plan. The imposition of Equalisation Levy, Country-by-Country reporting and Master File requirements under the transfer pricing provisions have their origins in the BEPS Project.

The Finance Bill 2017 proposes special provisions to restrict deduction of interest paid by an Indian company to its associated enterprises where the interest pay-out exceeds INR 10 million in a year. The interest deduction in such cases will be restricted to 30% of the EBITDA¹ of the borrower.

A significant impact of the MLI could be felt in the areas of tax treaty abuse and artificial avoidance of Permanent Establishment (PE) status.

Even before the MLI is signed, India has already amended its tax treaties with Mauritius, Cyprus and Singapore to deal with the artificial avoidance of tax liabilities in India.

Once the MLI is signed, a substantial number of the treaties signed by India would be covered under the principles of the BEPS Project. Any aggressive tax planning by using loopholes/gaps in the existing tax treaty provisions could be thwarted by the Indian tax authorities. This would significantly affect intermediate/holding company structures and cash-box companies.

Foreign entities operating in India under 'Commissionaire' models could also witness a significant impact. A commissionaire model involves an Indian entity securing orders in India for a foreign entity such that the ultimate contract of sale is concluded outside India between the foreign entity and the Indian customer. In such cases, under the existing regulations, the Indian entity pays tax on a small margin attributable to the marketing/sales function, commonly on a cost plus margin basis, even though virtually all efforts for securing the contract were carried out in India.

The MLI now provides, as an optional clause, that where the Indian entity plays a principal role in securing the contract, it can be considered as a PE of the foreign entity in India. This would require a higher attribution of profits to the Indian entity and increase the tax liability in India. The tax exposure here would also be linked to the transfer pricing policies of the Indian enterprise.

The MLI also contains provisions to deal with situations of artificially splitting contracts between different entities to avoid a PE status in India. The MLI provides for the aggregation of the contracts in such cases to examine the constitution of the PE. This will significantly affect enterprises undertaking Engineering Procurement and Commissioning (EPC) contracts or dealing with specialised installations/works.

Preparing for life under BEPS

Adherence to BEPS requirements would necessitate the evaluation of the functions performed by the Indian enterprise, the value added by it and its comparison to the overall functions performed by the group entities. Based on this evaluation, the PE exposure could be evaluated and the profit to be attributed to Indian operations could be determined based on transfer pricing principles. This activity could also involve amending the business model of the Indian entity to ensure tax optimisation and risk mitigation.

Action Plan 15 of the BEPS Project provides for the signing of a Multi-Lateral Instrument (MLI) to modify various tax treaties simultaneously. Once signed, the MLI would have to be read along with the various bilateral tax treaties.

1. Earnings before Interest, Taxes, Depreciation and Amortisation



ROLE OF TECHNOLOGY IN

FUTURE TAX COMPLIANCE AND REPORTING

“Once a new technology rolls over you, if you are not part of the steamroller; then you are part of the road”

Over the last few years, there has been an increased use of technology by the tax authorities and taxpayers alike.

This article points to the impact that technology will have on the Indian tax environment and how Indian taxpayers can use it to simplify their tax procedures.

Moving towards electronic scrutiny assessments (revenue audits)

Filing of tax returns, receiving queries from tax authorities and submitting responses have now moved towards the electronic mode of communication. The use of technology will further increase in the years to come, making almost the entire interaction through the electronic means. For instance, queries raised by the Tax Authorities and the submissions made during a scrutiny assessment (revenue audit) proceedings may soon be carried out online. The pilot project on electronic scrutiny assessments launched by the government is a step in this regard.

Specific and to-the-point discussions between taxpayer and Tax Authorities

Data-linkages between different arms of the government and the institutions in the financial system are enabling the Tax Authorities to capture better information about a taxpayer. In the times to come, we expect seamless assimilation of different aspects of taxpayer information such as bank accounts, incomes, expenses and investments through the key field of Permanent Account Number (PAN) and Aadhaar. This will result in particulars of a transaction and tax event becoming readily available to the Tax Authorities.

Data-linkages are expected to increase the tax compliance base, identify defaulters and make enquiries more specific and ‘to-the-point’. Under the Annual Information Return, considerable information about a taxpayer’s activities is being provided to the Tax Authorities. Using such streams of information, the government systems could have certain automatic triggers to capture transactions having values

Even simplistic technology solutions can significantly aid an in-house tax function.

disproportionate to a taxpayer’s reported income and/or scale of operations. Suspicious transactions could be caught on time. Furthermore, enquiries from Tax Authorities would become more specific to the taxpayer thereby saving time and effort at both ends and bringing the enquiry to a logical conclusion.

In a recently launched ‘Operation Clean Money’ to deal with cash deposits during the demonetisation period, the government has expressly discussed the use of data analytics to identify potential tax evaders.



Opportunities for an in-house tax function

From a taxpayer's perspective, the electronic form of data submission throws up significant possibilities for automation and reducing human effort to improve the efficiency of tax compliance and reporting functions.

A number of routine tax compliances can be largely automated by linking compliance forms with the taxpayer's accounting system. Interfaces could be developed where the compliance forms are auto-filled the moment an accounting entry is made. This could save the need for separate data compilation and collation for meeting compliance requirements.

Tax logic can also be built into the accounting system under a decision tree model. Presently, there are certain ERP packages where such functionality is available on a customisation basis. With the increased use of technology coupled with greater standardisation of tax matters, the tax logic can be built into virtually any accounting software and can be made available to taxpayers in a timely manner and at lower costs.

Even simplistic technology solutions can significantly aid an in-house tax function. An in-house tax team can develop a web-based portal to document the tax positions being taken in the past. This could significantly curtail the time and effort of subordinate staff in applying for a tax position and could also assist in training new employees. Furthermore, formula-based templates with adequate security checks could be developed for preparing computation of taxable income, advance tax workings, VAT payable positions net of input credit, to name a few.

Technology will play a significant role in bringing in more transparency in the Indian tax environment and will be a strong deterrent to unfair practices on the part of any stakeholder in the tax environment. It will also encourage voluntary compliance by making tax compliance and reporting an easy activity.

While it is certain that the tax world will use technology to greater extent, the pace of its implementation as compared to changes in the tax policies and procedures need to be gauged so that the taxpayer as well as Tax Authorities are equipped with appropriate technology at the appropriate time.



PENDING LITIGATION: JUDGEMENTS AWAITED; THAT WILL IMPACT BUSINESS HIGHLY

“Of life’s two certainties, there is only one for which you can get an extension”

In the recent past, there have been significant tax controversies in India which have been closely monitored around the globe by Multi-National Enterprises (MNEs), tax administrators, policy-makers and international tax organisations.

The dynamic nature of the present day business world along with aggressive tax planning measures and a protective approach to revenue often make it difficult for the law to expressly address all potential questions that may arise from its application in the future. This is where tax litigation plays a crucial role in the interpretation of law in different situations and provides the necessary aid for policy makers to amend the law wherever necessary. To this effect, tax litigation is an important pillar of tax certainty.

This write-up elucidates certain matters pending before the Supreme Court of India, which will have far reaching effects on businesses once the Court pronounces its verdict.

Does ‘excessive’ marketing expenditure in India result in the creation of marketing intangibles for oversea entities and does it call for transfer pricing adjustments?

The creation of marketing intangible has been the subject of much debate recently, when the Indian arm of a multinational entity incurs advertising, marketing and sales promotion (AMP) spend in India.

The tax authorities have adopted a position wherein, if Indian companies spend excessive amounts on AMP activities, it leads to the creation of marketing intangibles for the brand which is owned by a foreign multinational. Hence, Indian taxpayers ought to be compensated for the ‘alleged brand promotion services’.

This issue has led to an intense battle between the taxpayers and the Tax Authorities with the Special Bench of the Tribunal ruling in favour of the Tax Authorities, and the High Courts ruling in favour of the taxpayers.

The Supreme Court will now have to decide whether excessive AMP spend attracts transfer pricing provisions, and if yes, what is the right method for determining the arm’s length price of the AMP spend.

This is presently one of the most eagerly awaited verdicts from the Supreme Court, and it will have far reaching effects on the tax environment in India at large. It would be interesting to note whether the Supreme Court coins guiding principles around this issue or whether its verdict remains specific to the facts of a particular case.

If an Indian agent is a Permanent Establishment (PE) of the foreign principal but it is remunerated on an arm’s length basis, can further profit be attributed to the PE?

The Supreme Court of India in its earlier decision in the case of Morgan Stanley¹ has affirmed that when an agent is already paid on an arm’s length basis considering the risk taking functions of such an agent, there cannot be further attribution of profits to the PE. A similar view is pronounced by the Bombay High Court in the case of B4U Holdings Limited². The Tax Authorities have appealed against this judgment to the Supreme Court and the verdict is expected to be delivered in 2017.

It would be worth noting the verdict of the Supreme Court on this matter especially in light of the position of commissionaire arrangements under the BEPS Project. It would also be interesting to note whether Tax Authorities argue the matter on the basis of differential tax rates for an Indian company and for a PE, even though the amount of profit attributable to the PE does not change.

1. DIT v Morgan Stanley and Co., Inc (292 ITR 416)(SC)

2. DIT v B4U International Holdings Limited [2015](57 taxmann.com 146)(Bom)

The Finance Act, 2012 provided that failure to deduct TDS on expenditure does not result in disallowance if the payee has paid income-tax thereon. Can this amendment be given retrospective effect?

The Finance Act, 2012 provided that despite the failure to deduct tax by the payer, disallowance of the expenditure shall not be made if the resident payee has paid tax on the income received by it, subject to certain other conditions. This amendment was to take effect from 1 April 2013.

Certain courts and tribunals have taken a view that this amendment should be given retrospective effect and should also apply to periods before 1 April 2013. This matter is pending before the Supreme Court³.

This is an interesting case where the taxpayer is arguing to apply a law retrospectively. In certain earlier cases, Courts have held that if an amendment in the law is to address an existing anomaly, it can be applied to periods before the amendment. Given this backdrop, it will be interesting to note the position the Supreme Court takes on this particular issue.

Is Project Office acting merely as a Communication Channel to the foreign entity's project in India, a PE?

The Delhi High Court in a recent case⁴ dealt with a situation wherein a foreign company was undertaking certain projects in India for which it had opened a Project Office in India. The High Court held that the Project Office was not a PE of the foreign company since the Project Office was acting only as a communication channel for the foreign company and therefore was rendering only auxiliary services to the main project. The Tax Authorities took the matter before the Supreme Court.

The Supreme Court will decide whether splitting a contract between the foreign company and the Indian Project Office was done in order to avoid PE status in India or whether such a splitting of contract is permissible when the customer is located in India. Another aspect that could be considered is that while the BEPS Project provides specific rules to deal with artificial splitting of contracts, whether splitting of contracts is permissible under the existing law.

Splitting of contracts between different entities is not an uncommon practice particularly in the EPC sector. Hence, the Supreme Court verdict in this case will have far reaching effects on the taxation aspect of EPC contracts.

Whether service tax authorities can conduct Special Audits?

The Delhi High Court⁵ held that the power of Service tax authorities to conduct Special Audits and demand records under the Service tax legislation is ultra vires (bad in law) and had struck down the circular issued by the Central Board of Excise and Customs in this regard.

When the Tax Authorities approached the Supreme Court on this issue, the Supreme Court granted a stay on the order of the Delhi High Court as an interim measure, and the verdict of the Supreme Court on merits of the case is awaited.

If the Supreme Court decides the matter against the Tax Authorities, an amendment in the law to overcome the Supreme Court verdict cannot be ruled out.

The dynamic nature of the present day business world along with aggressive tax planning measures and a protective Revenue often makes it difficult for the law to expressly address all potential questions that may arise from its application in the future. This is where tax litigation plays a crucial role in the interpretation of law in different situations and provides the necessary aid for policy makers to amend the law wherever necessary.

3. CIT v. Ansal Landmark Township (P.) Ltd. (2015)(61 taxmann.com 45)(Del)

4. National Petroleum Construction Company (2016)(66 taxmann.com 16)(Del)

5. Mega Cabs Private Limited v Union of India and Others [WP No. 5192/2015]



SIGNIFICANT RULINGS PRONOUNCED IN THE LAST YEAR AND THEIR IMPACT ON TAX POSITIONS

“A lawsuit is a fruit tree; planted in the lawyer’s garden“

India is considered to be the land of tax litigation. The Indian litigation landscape assures a plethora of court rulings; 24 High Courts and over 70 benches of the Tribunal pronouncing verdicts on a regular basis. It is a daunting task for tax professionals and taxpayers to keep track of the rulings pronounced by the judicial authorities and to evaluate their impact on their tax positions.

We discuss some of the key judicial pronouncements of 2016 which are expected to significantly impact the Indian tax environment below:

Depreciation of goodwill arising on amalgamation – situation after the Supreme Court’s verdict

The ‘allowability’ of depreciation on goodwill generated in the course of merger was subjected to substantial litigation until the Supreme Court recognised goodwill as an eligible intangible asset and allowed depreciation thereon for tax purposes.¹

After the Supreme Court ruling, the litigation on the ‘allowability’ of depreciation on goodwill was expected to be put to rest. Courts and Tribunals began ruling in favour of the taxpayer without deliberating on any principles of allowability. However, recently the Bangalore Tribunal has interpreted the Supreme Court ruling differently² and disallowed the taxpayer’s claim of depreciation on goodwill on the principle that tax advantage cannot be derived out of a tax neutral transaction. The Tribunal’s ruling suggests that depreciation is allowable only where goodwill is supported by material evidencing the benefit derived by the taxpayer. If goodwill is merely an arithmetic difference between the consideration paid and assets acquired, it is not eligible for depreciation.

This ruling is likely to reignite litigation around depreciation on goodwill arising from business restructuring transactions.

Tax withholding on Export Commission to non-resident agents – parameters of taxability being laid down

Tax withholding on commission paid to non-resident agents has become an issue of litigation in recent times, with the Tax Authorities seeking to consider the commission as fees for managerial/technical/consultancy services.

Recently, the Bombay High Court ruled that even after the withdrawal of the Central Board of Direct Taxes (CBDT) Circular No. 23 of 1969, the commission paid to non-resident agents continues to remain non-taxable in India where services are rendered, used and paid for outside India and the agent does not have a business connection or a permanent establishment in India.

The Ahmedabad bench of the Income Tax Appellate Tribunal (Tribunal) has also ruled on similar lines and has stated that “Just because a product is highly technical, it does not change the character of the activity of the sale agent”.

If the principles laid down in these rulings are followed by other judicial authorities, the litigation around the taxability of export commission could be laid to rest. It goes without saying that the tax payers must take due care while drafting the agency agreements to bring out the true commercial intention and avoid the risk of litigation.

With 24 High Courts and over 70 benches of the Tribunal, the Indian litigation landscape assures a many different Court rulings every year. It is a daunting task for tax professionals and taxpayers to keep track of the rulings pronounced by the judicial authorities and to evaluate their impact on their tax positions.

1. CIT v Smifs Securities Limited [2012](24 taxmann.com 222)(SC)
2. United Breweries Limited v DCIT [TS-553-ITAT-2016](Bang)
3. Taurian Iron and Steel Co Pvt Ltd v ADIT [ITA No. 5920/Mum/2012]

Mumbai Tribunal³ discusses re-characterisation of share application money as a loan under transfer pricing regulations

The issue of re-characterisation of share application money as a loan comes up when the share application remains pending for allotment for a long period of time. If it is considered a loan, a transfer pricing adjustment can be made for the notional interest on such a loan and added to the income of the person paying the share application money.

In this regard, the Mumbai Tribunal held that the share application money cannot be considered as a loan due to the delay in the allotment of shares. However, if no share allotment was made and if the money was eventually refunded, the transaction will be considered to be a loan, and accordingly an international transaction. The Tribunal emphasised on the overall substance of the transaction and not its form. The imputed interest on the share application money was six months Libor plus 150 basis points.

This ruling should provide relief in ongoing litigation where there is a delay in the allotment of shares against the share application money.

Special bench discusses Base Erosion argument under transfer pricing provisions

The Special Bench of the Tribunal has dealt with the applicability of transfer pricing provisions where there is no erosion of India's tax base. This case⁴ involved a situation where income paid by an Indian company to a foreign enterprise was also liable to tax in India; hence the taxpayer's argument of no base-erosion.

The Special Bench held that while deciding the applicability of transfer pricing provisions, the existence of base erosion needs to be seen for the taxpayer alone and not in aggregate of the taxpayer and its associated enterprises overseas. Even if the arm's length nature of the transaction is demonstrated from the Indian company's point of view, the flip side of the same transaction may or may not continue to satisfy the principles of arm's length necessarily.

This ruling could expose foreign enterprises to transfer pricing adjustments on the income earned from India and could open up a new area for litigation.

Supreme Court upholds the constitutional validity of Entry Tax

The constitutional validity of Entry Tax laws of several states has been a subject matter of litigation for more than 50

years. This issue was placed before a nine Judge Constitution Bench of the Supreme Court of India and was led by the Chief Justice of India⁵.

After numerous rounds of submissions, arguments and hearings, the Supreme Court, by a majority of 7:2, upheld the validity of the state legislations imposing entry tax on the import of goods from other states.

This judgment settles the constitutional challenge to the levy of Entry Tax in favour of the government. Taxpayers challenging this levy will now have to comply with the Entry Tax requirements.

Supreme Court rules that sale of goods by an importer to the end customer in India qualifies to be covered under 'sale in course of import'

The Supreme Court held that the movement of goods by way of imports was in pursuance of the conditions and/or as an incident of the contract between the importer and the end customer in India⁶. Hence, sales made by importers to end customers in India should qualify as 'sale in the course of import'. The Supreme Court further held that the privity of contract between the foreign supplier and the end consumer in India was not mandatory to qualify as 'sale in the course of import'.

This judgment comes as a significant relief to importers, and particularly to taxpayers engaged in large scale turnkey contracts.

Ahmedabad Tribunal allows CENVAT credit on commission paid to overseas marketing agents

The Gujarat High Court in an earlier case had held that the commission paid to overseas marketing agents would not qualify for Central Value Added Tax (CENVAT) Credit .

The definition of the term 'input service' was later amended, vide notification number 2/2016-CX (NT) dated 3 February 2016, to provide that the sales promotion includes the services by way of sale of dutiable goods on a commission basis. The Ahmedabad Tribunal⁸ held that this notification has to be construed as having a retrospective effect and accordingly allowed CENVAT credit of service tax paid on commission paid to overseas agents.

This judgment provides relief to exporters who have appointed overseas commission agents who will help them in reduce their tax liability by availing CENVAT credit on such payments.

4. Instrumentarium Corporation Limited v DIT (I.T.A. Nos.1548 and 1549/Kol/2009) – ITAT Special Bench

5. M/s Jindal Stainless Steel Limited & Anr v State of Haryana & Ors [2016](11) TMI-545-SC

6. Commissioner Delhi VAT v M/s ABB Limited [TS-155-SC-2016-VAT]

7. Cadila Healthcare Limited [2012-VIL-119-Guj HC]

8. M/s Essar Steel India Limited V/s Commissioner of Central Excise & Service Tax, Surat-I [2016-VIL-155-CESTAT-AHM]

Our Insights

We constantly work on sharing relevant alerts and publications to keep you informed on the latest developments in India and globally. Write to skpgrp.info@skpgroup.com to receive any of the following publications.



Assurance Insights

Monthly newsletter providing insights into company law, accounting and assurance-related developments in India.



Connect the GAAP

Monthly newsletter providing insights into Indian Accounting Standards and International GAAP.



Medical Device

Publication analysing the changing dynamics and environment of the Indian medical device industry.



Global Expansion Updates

Monthly newsletter providing employment, payroll, GST/VAT and corporate tax related developments across the world.



Transfer Pricing 360°

Quarterly newsletter providing key insights into the recent transfer pricing developments in India and across the globe.



Tax Trends

Quarterly newsletter providing insights into key direct tax developments in India.



Investment Chronical

Updates providing a snapshot of key foreign direct investments in India.



Subscribe to our insights

Key contacts



Maulik P. Doshi
Partner
International Tax and Transfer Pricing
E: maulik.doshi@skpgroup.com



Pratik Shah
Partner
Indirect Tax
E: pratik.shah@skpgroup.com

Our Offices

Chicago

2917 Oak Brook Hills Road
Oak Brook
Chicago 60623

T: +1 630 818 1830

Mumbai

19 Adi Marzban Path
Ballard Estate, Fort
Mumbai 400 001

T: +91 22 6730 9000

Pune

VEN Business Centre
Baner-Pashan Link Road
Pune 411 021

T: +91 20 6720 3800

Toronto

269 The East Mall
Toronto
ON M9B 3Z1

T: +1 647 707 5066

Hyderabad

6-3-249/3/1 SSK Building
Ranga Raju Lane, Road 1,
Banjara Hills, Hyderabad 500 034

T: +91 40 2325 1800

New Delhi

B-376
Nirman Vihar
New Delhi 110 092

T: +91. 11 4252 8800

Dubai

2303 Orra Marina
Nasaq Street, Dubai Marina
Dubai, UAE

T: +971 4 325 2245

Chennai

3 Crown Court
128 Cathedral Road
Chennai 600 086

T: +91 44 4208 0337

Bengaluru

312/313 Barton Centre
Mahatma Gandhi Road
Bengaluru 560 001

T: +91 80 4277 7800

skpgroup.com

skpgrp.info@skpgroup.com



[linkedin.com/company/skp-group](https://www.linkedin.com/company/skp-group)



twitter.com/SKPGroup



[facebook.com/SKPGroupIndia](https://www.facebook.com/SKPGroupIndia)



plus.google.com/+SKPGroup



[youtube.com/c/SKPGroup](https://www.youtube.com/c/SKPGroup)



Subscribe to our insights

Whilst every effort has been made to ensure the accuracy of the information contained in this document, the same cannot be guaranteed. We accept no liability or responsibility to any person for any loss or damage incurred by relying on the information contained in this document.

SKP Business Consulting LLP is a member firm of the "Nexia International" network. Nexia International Limited does not deliver services in its own name or otherwise. Nexia International Limited and the member firms of the Nexia International network (including those members which trade under a name which includes the word NEXIA) are not part of a worldwide partnership.

© 2017 SKP Business Consulting LLP. All rights reserved.

A member of
Nexia
International