

Pre-Budget Memorandum 2016-17

Direct Taxes



American Chamber of Commerce in India

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1. International Taxation

1.1.1 Provisions regarding indirect transfer_of capital asset situated in India

The Finance Act, 2015 has amended provisions dealing with indirect transfer of capital asset situated in India. The amendment provides clarity on certain contentious aspects with regards to taxation of income arising or accruing from such indirect transfers. The following amendments have been introduced in the Act.

- Share or interest in a foreign company or entity shall be deemed to derive its value substantially from Indian assets only if the value of Indian assets (whether tangible or intangible) as on the specified date exceeds the amount of INR 10 crores and represents at least 50% of the value of all the assets owned by the foreign company or entity.
- The value of an asset shall be its Fair Market Value (FMV).
- The date of valuation of assets (without reducing the liabilities) shall be as at the end of the accounting period preceding the date of transfer. However, in case the valuation of assets as on the date of transfer exceeds by at least 15% of book value of the assets as on the date on which the accounting period of the company/entity ends preceding the date of transfer, then the specified date shall be the date of transfer.
- Exemption from applicability of the aforesaid provision has been provided in the following situations
 - Where the transferor along with its related parties does not hold (i) the right of control or management; (ii) the voting power or share capital or interest exceeding 5% of the total voting power or total share capital in the foreign company or total interest in the entity directly holding the Indian assets (Holding Co).
 - In case where the Indian assets are not directly held, then if the transferor along with related parties does not hold (i) the right of management or control in relation to such foreign company or the entity; and (ii) any rights in such foreign company which would entitle it to either exercise control or management of the holding company or entitle it to voting power exceeding 5% in the holding company.
- The Finance Act, 2015 has introduced Section 47(vicc) in the Income-tax Act, 1961 which, subject to fulfillment of certain conditions provides that transfer of shares of a foreign company (which directly or indirectly derives its value substantially from shares of an Indian company) by the demerged foreign company to the resulting foreign company under a scheme of demerger will not be regarded as transfer.
- The Indian entity will be required to furnish information relating to indirect transfers. In case of any failure, the Indian company will be liable for a penalty of INR 500,000 or 2% of the value of the transaction as specified.
- There are no provisions in the Act which exempts the Participatory-Note (P-Note) holders from the applicability of the provisions of indirect transfer on sale of P-Notes outside India.

Recommendations

- At the onset, it is respectfully submitted that the tax on 'indirect transfers' is a new levy and should therefore have prospective application. It is therefore respectfully submitted that the Shome Committee's recommendation that the provisions relating to taxation of indirect transfer as introduced

by the Finance Act, 2012 are not clarificatory in nature and would widen the tax base and consequently should only have prospective application, be accepted and the Act be amended suitably.

- **Valuation Rules:** Further, reasonable guidelines should be provided for determination of fair market value in connection with indirect transfers on priority basis. In cases where the shares of the Indian company are listed, the valuation rules should provide that the closing market price of such shares on the specified date must be the value for the purposes of Explanation 6. In cases where the shares of the Indian company are not listed, the Discounted Cash Flow (DCF) Method should be prescribed as the sole basis for determining the value of Indian shares. This will be in line with internationally accepted norms of valuation. In order to mitigate the possibility of litigation (given the inherent subjectivity in valuation) it could be provided that the valuation must be undertaken/certified by a chartered accountant or a Category 1 Merchant Banker. This will be similar to the approach adopted under the FEMA pricing guidelines for issue/transfer of shares. It may additionally also be provided that such a valuation (duly certified by a Merchant Banker / Chartered Accountant) will not be ordinarily be disturbed or challenged by the tax authorities. Further, for foreign companies also, similar valuation rules should be provided to avoid subjectivity and possible litigation.

- “Explanation 5 to Section 9(1)(i) clarifies that an asset or a capital asset being any share or interest in a company.....”. Whether all and any type of asset, for e.g. stock-in-trade, any other non-capital asset, etc., will be covered by this Explanation or whether it will be restricted to only capital asset in the nature of share or interest in an entity, needs to be clarified. Therefore, clarity is required on interpretation of this phrase.
- Clarification should be provided for the phrase ‘assets located in India’ mentioned in Explanation 5 to Section 9(1)(i), given that the following interpretations are possible:
 - Whether the section refers to shares of an Indian company as assets located in India; or
 - Whether it is referring to the assets owned and held by the Indian company whether in India or outside India.
- If one goes with the amendment proposed for calculating FMV of assets i.e. to be calculated without reducing liabilities, then, one may interpret ‘assets located in India’ as all the assets of the Indian company. In case the phrase ‘assets located in India’ refers only to shares of the Indian company, then, even liabilities of such Indian company should be considered for a correct determination of FMV. Therefore, clarity is required on the same.

- **Exclusion for Listed Securities:** No Indian tax should be imposed where the shares of the foreign company are listed and traded on a stock exchange outside India as the Identity of the seller not ascertainable for transactions done on stock exchange. Such cases also pose significant challenges from the point of view of withholding, given that the identity of the seller is not ascertainable in transactions undertaken on a stock exchange. Further challenges exist in respect of ascertaining whether the seller holds more than 5% or not, whether the shareholder qualifies for treaty benefits, his cost of acquisition etc. Even if one were to take the view that withholding is merely a tentative determination of tax, and is subject to the correct determination at the time of assessment, the practical challenges in requiring investors in stock markets around the world to obtain a TAN in India, deduct tax, and deposit the same with the government, and issue TDS certificates without even knowing the identity of the person on whose behalf such tax is deposited are simply mind-boggling. The Parliamentary Standing Committee Report on Direct Tax Code Bill, 2010 and the Shome Committee Report also supports the above

position and hence the law should be amended so that indirect transfer provisions do not apply to the shares of listed companies.

In view of the above, it is submitted that the provisions of the Act relating to indirect transfers should be suitably modified to provide for an additional exclusion from capital gains liability in cases of transfer of shares of foreign companies which are listed and regularly traded on recognized stock exchanges abroad. The criteria for recognition of stock exchanges and for determination of the regularly trading threshold may also be suitably clarified.

- Intra-group transfers as part of group re-organizations (other than amalgamation and demerger) should also be exempt from the indirect transfer provisions.
- While Explanation 5 to Section 9(1)(i) provides that shares of a foreign company which derives directly or indirectly its substantial value from the assets located in India shall be deemed to be situated in India. Section 47(vicc) provides exemption only if the shares of foreign company derive substantial value from shares of an Indian company. While the intent may be to exempt all cases of demerger where foreign company derives substantial value from assets located in India, the reading of Section 47(vicc) indicates that the said exemption would be available only in cases where the shares of the foreign company derive substantial value from shares of Indian company. Due to this inconsistency in the language of Section 47(vicc) vis-à-vis Explanation 5 to Section 9(1)(i), transfer of shares of a foreign company which derives its value predominantly from assets located in India (other than shares of an Indian company) under a scheme of demerger may be deprived of the aforesaid exemption. It is recommended that Section 47(vicc) should be amended to provide that *“any transfer in a demerger, of a capital asset, being a share of a foreign company, referred to in Explanation 5 to clause (i) of sub-section (1) of section 9, which derives, directly or indirectly, its value substantially from the **assets located in India**, held by the demerged foreign company to the resulting foreign company, if,—*

Similar amendment should also be made in Section 47(viab) (i.e. in case of amalgamation).

- Explanation 6 introduced in the Finance Act, 2015 prescribes a threshold for applicability for the indirect transfer provisions i.e. the share or interest, referred to in Explanation 5, shall be deemed to derive its value substantially from the assets located in India, if, the value of such assets (i) exceeds the amount of ten crore rupees; and (ii) represents at least 50 per cent of the value of all the assets owned by the company or entity, as the case may be. There should also be a minimum threshold prescribed for reporting of transactions by the Indian entity. It should be clarified that the same threshold will apply for reporting of transactions under Section 285A.
- The onus of reporting has been cast on the Indian entity. Generally, the Indian entity may not have information relating to overseas indirect transfer, therefore, the onus of reporting should not be cast on the Indian entity. Considering that the provisions relate to indirect transfers, the onus, if at all, should be cast on the parties to the transaction and not the Indian entity.
- The provisions of ‘Indirect transfer’ should be amended so as to explicitly exempt the P-Note holders from the applicability of the provisions of indirect transfer to provide certainty to Foreign Institutional Investors (FII) [who pay taxes in India on their income earned/derived in India] to encourage more foreign investments in India.
- Small shareholder exclusion: A small shareholder exclusion is provided for in the Act in respect of shareholders whose stake does not exceed 5%. This exclusion is not available to any shareholder whose stake at any time in the twelve months preceding the date of transfer exceeds 5%.

In this regard, it is submitted that the Income-tax Act be suitably modified such that the shareholding as on the date of the transfer alone is considered for the purpose of this exemption and that the condition of requiring examination of shareholding for the 12 month period preceding the transfer be done away with

- Provisions of Section 234A, 234B, 234C and 201(1A) should not be applied in cases where a demand is raised on an assessee on account of retrospective amendment relating to indirect transfer. An appropriate amendment should be made in the respective Sections.

1.1.2 Exempt foreign lenders from PAN in respect of interest paid on foreign currency loans.

Issues

- Foreign loans constitute a very important source of funds for passive infrastructure industry in India both for financing import of capital goods as well as raising funds for embarking on expansion.
- Foreign lenders generally negotiate on interest rates (net of taxes of the borrower country) and in most cases, Indian borrowers have to bear the cost of TDS in India. Section 206AA results in substantially higher cost of borrowing for Indian infrastructure companies

Recommendations

- It is recommended for the exclusion of transactions covered by section 194LC from the purview of Section 206AA.

1.1.3 Offshore fund management in India

Issues

- Section 9A of the Income Tax Act, 1961 ('the Act'), provides that having a fund manager in India does not create a tax presence (business connection) for the fund in India or does not result in the fund being considered a resident in India, subject to fulfillment of certain stringent conditions by the fund and the fund manager. Major such conditions are:
 - 1 No remuneration to fund manager in case fund performance is a loss
 - 2 Restriction on investments of the fund in one entity ['in India'?] to be < 20% of the fund corpus; underlined words to be added/ clarified
 - 3 Difficulty in tracking 'connected persons' for deciding eligibility of fund
 - 25 non-connected persons in each fund
 - 10 non-connected persons to hold < 50% fund assets
 - direct and indirect holding by Indian resident along with connected person > 5% of the corpus of the fund

Recommendation

- The condition provided in section 9A of the Act seems to cover primarily broad based fund more specifically Category I and Category II- Foreign Portfolio Investors. If the intention of the

government is to grant benefits to only such category of investors, then conditions should be aligned to SEBI regulations.

- With regards to maintaining monthly corpus of INR 1,000 Million, flexibility should be granted at the initial and last phases of the scheme.

Cap on remuneration to fund managers (i.e. up to 20% of profits accruing and arising to the fund) seems totally unnecessary especially given the fact that one of the conditions under Section 9A of the ITA does require such remuneration to be at arm's length. Further, clarifications should be issued in case the offshore funds making losses.

1.1.4 Every foreign company requires to file tax return even if they have only FTS / Royalty Income and other exempted income.

Issues

Every foreign company requires to file tax return even if they have only FTS / Royalty Income and other exempted income.

Section 115A(5) of the Act provides relaxation from filing of return, subject to appropriate tax withholding, only in respect of incomes covered under clause (a) (i.e., dividend and interest income) and not in respect of incomes under clause (b) of (i.e., royalty and FTS income). This is despite the fact that the Act as well as most of the DTAA's entered into by India provide for specific rates of tax withholding in respect of FTS / royalty incomes and other exempted income (capital gains).

Recommendation

In addition to the interest and dividend income, section 115A(5) of the Act should be extended to cover Royalty and Fees for technical services as well. Also income exempt on account of treaty benefit (such as capital gains) should also be exempted from filing returns.

1.1.5 Limitation for passing order in the case failure to deduct tax on payment to non-resident u/s 201(1A)(3)

Issues

Section 201(1A)(3) of the Act, provides no order deeming a person to be an assessee in default for failure to deduct whole or any part of the tax from the person resident in India is passed after the expiry of 2 years in case of statements referred to in section 200 has been filed and 6 years in any other case. It may be noted that no such time limit for passing such order has been prescribed in the Act in case of failure to deduct tax from non-resident.

Recommendation

The absence of time limit in case of failure to deduct tax from a non-resident seems to be an omission in the provisions of the Act.

It is suggested that an appropriate time limit similar to the one applicable for failure to deduct tax in case of person resident in India may be imposed for passing order by the Assessing officer on failure to deduct tax on payment to non-resident.

1.2 Place of Effective Management

In determining the residential status of a person being a company, the provisions are amended, such that a company having Place of Effective Management (POEM) in India in that year, would be considered to be resident of India. Further, POEM means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, are in substance made.

Given that the changes proposed are new from an Indian perspective, appropriate guidelines/Frequently Asked Questions (FAQ) should be issued to provide clarity to the taxpayers on various questions relating to POEM. Some of the key issues and related recommendations are illustrated as follows:

- The term ‘commercial’ as contained in the POEM definition is very wide, therefore, the same should be replaced in line with the internationally accepted principles.
- There should be clarification in relation to terms used in the definition of POEM like ‘in substance made’, etc.
- Issue may arise as to at which point of time in the previous year, the residential status has to be determined viz. at the beginning of the year or the end of the previous year. The section does not specify timing of such examination. This is a critical point and has many implications. For example, the tax deduction provisions applicable to resident and non-resident are different. If the residential status determination is done at the end of the year, then how such tax deduction provisions operate where obligation for deduction would depend on the residential status? Therefore, it is recommended that necessary clarification in this regard should be issued. The determination of POEM happens only on the occurrence of the relevant transactions. Accordingly, the provisions of POEM should apply post the occurrence of the relevant transactions.
- In this global scenario, managers working and residing in multiple jurisdiction can communicate through the use of technology rather than physically meeting in one location to take decisions. Therefore, if technology is used as the key medium for making management and commercial decisions, each jurisdiction in which a manager is located at the time of decision making can be regarded as a place of management. Therefore, it is recommended that a detailed guideline with respect to such scenarios should be issued.

1.3 General Anti Avoidance Rules - Chapter X-A

The Finance Act, 2015 deferred implementation of General Anti Avoidance Rules (GAAR) by two years so as to introduce provisions of GAAR with effect from financial year 2017-18. It has been proposed that GAAR will apply to investments made on or after 1 April 2017, when GAAR is implemented. GAAR related recommendations are as follows:

1.3.1 Factors relevant for determining impermissible arrangements

Section 97(4) provides that factors like, period or time for which the arrangement exists, the fact of payment of taxes and the fact that an exit route is provided by the arrangement, may be relevant but shall not be sufficient for determining whether an arrangement lacks commercial substance or not.

Apart from the circumstances provided for clarifying whether the arrangement lacks commercial

substance, the following additional points may also be considered relevant for determining whether the arrangement is an impermissible avoidance arrangement:

- the form and substance of the transaction in which the scheme was entered into or carried out;
- whether the transaction is a single isolated transaction or a series of transactions;
- the change in the financial position of the taxpayer that has resulted or will result from the transaction; and
- the change in the financial position of the party connected to the relevant taxpayer that has resulted or will result from transaction.

1.3.2 Scope of the term 'significant' in Section 97(1)

Section 97(1) provides for a condition that an arrangement shall also be considered to be lacking commercial substance, if it does not have a significant effect upon business risks, or net cash flows apart from the tax benefit.

- The term 'significant' is not defined to quantify the actual risks/ net cash flows in order to conclude that the arrangement lacks commercial substance. Therefore, the term “*significant*” needs to be defined appropriately to avoid potential litigation.

1.3.3 DTAA vis-a-vis domestic tax laws

Section 90(2A) provides that the provisions of GAAR should apply to the taxpayer even if such provisions are not beneficial to him.

A Double Taxation Avoidance Agreement (DTAA) is a bilateral agreement entered between two sovereign governments. As per Article 26 and 31 of the Vienna Convention, a DTAA should be implemented in good faith. Further as per Article 27 of the Vienna Convention, a Government cannot invoke its internal law as a justification for its failure to perform the DTAA. Therefore, a unilateral amendment in the domestic law of any particular country cannot override a DTAA which has been signed with full knowledge, understanding and consent of both of the Governments. Therefore, Section 90(2A) should be withdrawn since the same is against the internationally accepted principles.

1.3.4 Appeals against directions of Approving Panel

Section 144BA provides that the directions issued by the Approving Panel shall be binding on the taxpayer and the Commissioner and no appeal under the Act shall lie against such directions.

The direction issued by the Approving Panel is as per the provisions. Therefore, taxpayer should be provided with a right to appeal against such directions

1.3.5 Other recommendations

- From a foreign investor’s standpoint, it is critical to have certainty on whether or not offshore foreign investors investing into India would be entitled to DTAA benefits, as may be applicable. If GAAR is invoked, DTAA benefits could be denied. Further, the language of the conditions triggering GAAR including ‘misuse or abuse of provisions of tax laws’, ‘lacks commercial substance’, ‘not for bonafide purposes’ and ‘substantial commercial purpose’ etc. are very widely worded and subjective. This could be amenable to various differing interpretations. This would result in significant uncertainty on whether structures set up by foreign investors would be respected and whether DTAA benefits would be granted. Therefore, the following recommendations are made:
- Certain objective criteria/ conditions should be laid down, which if fulfilled would not result in the triggering of GAAR provisions and its consequential implications on any offshore entity including denial of DTAA benefits. The term ‘lacks commercial substance’ is already being defined in the Act, however; it can further be elaborated for e.g. under the provisions of Section 97(4) some more criteria can be added

for determination of whether an arrangement lacks commercial substance or not. Certain objective criteria/ conditions can also be added to provide clarity on the applicability of the GAAR provisions for e.g. payment of adequate tax may be considered as a relevant factor for non-applicability of GAAR provisions.

- The clarification on the objective criteria/ conditions should also include examples (like incurrence of minimum specified expenditure by the overseas entity) where GAAR provisions would not be triggered.
- As per the notified Rules, the provisions of GAAR shall not apply to an arrangement where the tax benefit arising to all the parties to the arrangement in the relevant Assessment Year (AY) does not exceed INR 3 crore in aggregate. This threshold limit should be further enhanced so as to capture only highly sophisticated structures.
- Many countries do not apply GAAR where Special Anti Avoidance Rules (SAAR) is applicable for e.g. Transfer Pricing provisions, Section 40A(2), anti-dividend stripping provisions, anti-bonus stripping provisions, deemed dividend provisions under Section 2(22), Section 269SS, 269T, etc. It is a settled principle that, where a specific rule is available, a general rule will not apply. SAAR normally covers a specific aspect or situation of tax avoidance and provides a specific rule to deal with specific tax avoidance schemes.
- It is recommended that where GAAR and SAAR both are in force, only one of them will apply subject to prescribed guidelines. For e.g. Where a DTAA contains a Limitation on Benefits clause, GAAR should not have any application
- A distinction between tax mitigation and tax avoidance should be made to ensure that legitimate business choices do not result in the invocation of GAAR. To ensure clarity, as recommended by the Shome Committee, an illustrative negative list of such instances where GAAR cannot be invoked should be issued.
- Detailed illustrations must be given through Guidelines/Circulars to appropriately clarify the provisions of GAAR. The Report on GAAR issued by the Shome Committee provides guidelines and various illustrations/examples which can be used for issuing the detail Guidelines on the same.

1.4 Requirement for non-residents having no place of business in India to comply with Tax Deducted at Source (TDS) obligations - Section 195

The Finance Act, 2012 extended the obligation to withhold taxes to non-residents irrespective of whether the non- resident has—

- a residence or place of business or business connection in India; or
- any other presence in any manner whatsoever in India.

The aforesaid amendment was introduced with retrospective effect from 1 April 1962.

This amendment results in a significant expansion in the scope of withholding provisions under the Act and will cover all non-residents, regardless of their presence/connection with India.

The Supreme Court in the case of Vodafone International Holdings B.V. has observed that tax presence is a relevant factor in order to determine whether a non-resident has a withholding obligation in India under Section 195.

The amendment by the Finance Act, 2012, however, seeks to expressly extend the scope of withholding tax obligations to all persons including non-residents, irrespective of whether they have a residence/ place of business/business connection or any other presence in India. The amendment should be modified to restrict the applicability of withholding tax provisions to residents and non-residents having a tax presence in India.

Alternatively, the amendment should be made effective only prospectively. Making such a provision applicable with retrospective effect will operate harshly on persons who may have made payments based on the law prevalent prior to the amendment.

1.5 Information to be furnished for making remittance abroad - Section 195(6)

Issues

- The Finance Act, 2015 amended Section 195(6) which provides as follows:
‘The person responsible for paying to a non-resident, (not being a company), or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall furnish the information relating to payment of such sum, in such form and manner, as may be prescribed.’
- As per section 195(6) read with Rule 37BB of the Income-tax Rules, 1962 (the Rules), a person making remittance to a non-resident is required to submit Form 15CA electronically on the website designated by the income tax department and is further required to get a certificate from a Chartered Accountant (CA) in Form 15CB in respect of the particulars filled in Form 15CA.
- In August 2013, the Central Board of Direct Taxes (CBDT) had amended Rule 37BB of the Rules vide its Notification No. 58 of 2013, dated 5 August 2013, to broaden the requirement of collecting information and reporting requirements for all remittances outside India. The Rule also prescribes to provide information in cases where amounts are not liable to be taxed under the Act.
- The CBDT issued notification no. 67 of 2013, dated 2 September 2013, which has further revised the scope and the format of reporting of information under Rule 37BB of the Rules. It provides that the person responsible for making any payment including any interest or salary or any other sum chargeable to tax under the Act shall be required to furnish details in the prescribed forms. The notification also provides a specific list of payments which are not required to be reported under the revised rule. The amended Rule has come into force from 1 October 2013.
- There was ambiguity with respect to whether the amended rule would apply to transactions which are not chargeable to tax such as import of goods or payments in the nature of Fees for Technical Services (FTS)/ royalty, which are not taxable in India by virtue of beneficial Double Taxation Avoidance Agreements (DTAA) provisions. “Import of goods” is one of the transactions, which was included in the specified list, prescribed vide notification no. 58 of 2013 and then deleted from the specified list vide notification no 67 of 2013.
- In view of above amendment to Section 195(6) once again the issue has arisen as to whether the taxpayer needs to obtain a CA certificate in form 15CB and provide particulars in form 15CA for payments which are not chargeable to tax. Though Explanation 2 to Rule 37BB of the Rules contains some listings it does not unequivocally lend clarification for certain payments which are not chargeable to tax under the Act for e.g. payment for import of goods/raw materials, payment relating to gifts, certain capital payments, etc. Therefore, taxpayer making such payments faces the hardship while remitting such amounts.
- The amendment mandates reporting of even non-taxable transactions. As the foreign remittances in case of entities having multi-territorial operations are generally voluminous, reporting of each transaction along with obtaining a CA certificate could be a very daunting task. This would increase the number of

certificates that would have to be taken by the payer further entailing an increase in the compliance cost. This coupled with the fact that not all payments made to non-residents are necessarily chargeable to tax, there being several considerations which contribute to conclude about the taxability of payments made to non-residents, would increase the compliance burden associated with Form 15CA and 15CB reporting in case where the payments are not chargeable to tax.

- The Finance Act, 2015 has also introduced penalty in case of failure to furnish information or furnishing of inaccurate information as required to be furnished under Section 195(6), to the extent of INR one lakh.

Recommendations

- An Amendment should be brought into effect to roll back the cumbersome compliance requirement demanding filing of Form 15CA and Form 15CB while making every remittance even though such remittance may not be taxable in India.
- This is needed more so in respect of regular trade payments (imports) and it will also reduce hassles of doing business with India. Even payments which have been specifically exempt under the Act (for e.g. dividend payments, life insurance maturity proceeds, etc.), personal remittances (for e.g. payments for travel, education, maintenance of family abroad, etc.) capital account transactions (falling outside the ambit of Section 4, 5 and 9) should be specifically excluded for the purpose of complying with the requirements of Form 15CA and 15CB.
- A list of small value of payments within a specified limit for e.g. up to Indian Rupees (INR) one lakh equivalent to the amount of penalty should be kept out of the purview of the reporting compliance for the purpose of Section 195(6) .
- The penalty of INR one lakh should not be levied qua the payment, rather should it be qua the financial year linked to a specified contract value. It should be clarified that penalty ought to be levied only there is a non-disclosure or inaccurate disclosure of information wilfully leading to non-deduction of tax on remittances which are chargeable under the provisions.

1.6 Alternate Dispute Resolution Routes

- In order to resolve excessive tax litigation in India, alternate dispute resolution routes such as Authority for Advance Rulings (AAR), Advance Pricing Agreement (APA), Settlement Commission and Mutual Agreement Procedure under the DTAA have been introduced by the Government. However, such dispute resolution routes have not been able to curtail litigation in a timely and effective manner. Therefore, following the recommendations have been made:
 - The backlog in relation to pending AAR/APA applications should be cleared so that the investor community's confidence in the ability of the system to provide clarity expeditiously is strengthened.
 - The time limit for passing orders should be adhered to by the AAR.
 - The scope, mandate and functioning of the Settlement Commission needs to be reframed in the light of providing a meaningful and time bound dispute resolution mechanism.

The Indian Revenue Authorities have been taking a stand to deny filing of bilateral APA for settling transfer pricing disputes in the absence of Article 9(2) in the DTAA entered between India and other countries, which allows corresponding transfer pricing relief in the host country. It is suggested that a taxpayer should be allowed to file a bilateral APA even in cases where Article 9(2) is not provided in such DTAA.

2. Corporate Taxation

2.1 Increase in the rate of surcharge increases cost of doing business for domestic companies

The Finance Act 2015 has increased the rate of surcharge levied on domestic companies by 2%. The surcharge at the rate of 7% shall be levied in case of a domestic company if the total income of the domestic company exceeds INR one crore but does not exceed INR ten crore and at the rate of 12% in case total income exceeds INR ten crore.

The Finance Minister in his Budget (2015) speech stated that the Wealth tax will be abolished and it will be replaced with an additional surcharge of 2% on the super-rich with a taxable income of over INR 1 crore.

The comparative scenarios of tax rate for domestic companies (*including surcharge and education cess*) is as follows:-

Particulars	Income up to INR 1 crore	Income above INR 1 crore but up to INR 10 crore	Income above INR 10 crore
Earlier scenario	30.9%	32.445%	33.99%
Current scenario	30.9%	33.063%	34.608%

The Finance Act, 2015 has also increased the surcharge rate from 10% to 12% on Dividend Distribution Tax (DDT). The increase in surcharge by 2% will bring the effective dividend distribution tax rate to 20.358% as against the present rate of 19.995%.

Recommendations

- The increased rate of surcharge on tax makes cost of doing business in India significantly high. The increased tax cost will adversely impact the investors' sentiments and economic growth. It is recommended that the levy of additional surcharge on tax rates be removed (regardless of the ceiling of income) on domestic companies.

2.2 Rationalization of MAT rates

- The purpose behind introduction of Minimum Alternate Tax (MAT) was to bring all zero tax companies within the tax net and to neutralize the impact of certain benefits/incentives. The Finance Minister while introducing the Finance Act, 2015 announced to reduce the rates of corporate tax from 30% to 25% in a phased manner. The Finance Minister further stated that the reduction of tax has to be necessarily accompanied by rationalization and removal of various kinds of tax exemptions and incentives for corporate taxpayers.
- With the exemptions and incentives being phased out for corporate taxpayers, it would be necessary that the MAT provisions, which were introduced to bring in the tax net, the corporate taxpayers which were otherwise not being taxed, should also be streamlined.

Recommendations

- It is recommended that with the phasing out of incentives and reduction of corporate tax rates, the burden of MAT should also be gradually reduced from the current levels of 18.5% to a rate which will match with the reduction of tax rates and phasing out of tax exemptions and incentives.
- The MAT credit is recommended to be allowed as carried forward and set-off without any time limit.

2.2.1 Minimum Alternate Tax – Set-off of both book loss and depreciation

- Section 115JB of the Income-tax Act provides for reduction of loss brought forward or unabsorbed depreciation, whichever is less as per books as a reduction from net profits while computing book profits. The Explanation further states that if loss brought forward or unabsorbed depreciation is nil, no amount shall be reduced.
- Tax on book profits is a tax on notional income and was introduced to levy tax in case of companies which though earning net profits and declaring handsome dividends do not pay taxes under normal provisions of the Act on account of various incentives / deductions.
- The law currently provides reduction of book loss or unabsorbed depreciation, whichever is lower. Vide Finance Act, 2002, by way of an Explanation it was clarified that if one of the elements is nil, no reduction shall be allowed. However, no reason was provided in the Memorandum for such clarification. Prior to such amendment, benefit for entire book loss and depreciation continued to be provided by Legislature.
- For the purposes of discussing the economic argument behind availability of aforesaid provision, companies should be dissected in two baskets i.e. one set of companies would be companies earning net profits year on year but not paying taxes under normal provisions of Income-tax Act and the other being companies historically making net loss but subsequently turning into making net profits.
- It may be noted that a company is said to make profits only if it has wiped off all the past losses, both book loss and unabsorbed depreciation and earned net profits during a particular year. To consider set-off of only one element i.e. either book loss or unabsorbed depreciation while computing book profits, usually the latter, would only be a half-hearted relief while taxing a company notionally on its net profits.
- The provision of Companies Act also allows a company to freely distribute profits to shareholders post set-off of all past losses. In such a situation, taxing a company on its net profits for a year, that too notional, without reduction of past book losses would not be fair. The very intent behind introduction of minimum alternate tax to tax companies earning net profits and declaring dividends but not paying taxes seems to be defeated in the instant case.

- The Legislature should on the contrary incentivize historically loss making company turning into net profits by allowing reduction for entire book loss and depreciation before subjecting them to MAT. This shall enable a company to recoup all its past losses, stabilize for next few years and then be on a growth trajectory.

Recommendation

- The above clause should be suitably amended to provide that book loss and unabsorbed depreciation shall be allowed as a reduction from net profits even if one of the element is nil.

2.3 Dividend Distribution Tax - Section 115-O

Issues

- As per the provisions of Section 115-O , the domestic holding company will not have to pay DDT on dividends paid to its shareholders to the extent it received dividends from its subsidiary company on which DDT has been paid by the subsidiary. The current provisions give relief in respect of dividend received from only those companies in which the recipient companies are holding more than half of the nominal value of equity capital.
- DDT currently is payable at the basic rate of 15%. Further, dividends distributed by domestic companies and mutual funds will be grossed up for the purpose of computing DDT, translating into an effective tax rate of about 20% (after the levy of surcharge of 12% and cess of 3%).
- The Memorandum explaining the provision of the Finance (No.2) Bill, 2014 states that prior to introduction of DDT, the dividends were taxable in the hands of the shareholder. However, after the introduction of the DDT, a lower rate of 15% is currently applicable but this rate is being applied on the amount paid as dividend after reduction of tax distributed by the company. Therefore, the tax is computed with reference to the net amount. In order to ensure that tax is levied on proper base, the amount of distributable income and the dividends which are actually received by the shareholder of the domestic company need to be grossed up for the purpose of computing the additional tax.

The above memorandum appears contrary when compared with the speech of the Finance Minister who while introducing the DDT in the Budget of 1997-98 stated as follows: “*Some companies distribute exorbitant dividends. Ideally, they should retain the bulk of their profits and plough them into fresh investments. I intend to reward companies who invest in future growth. Hence, I propose to levy a tax on distributed profits at the moderate rate of 10% on the amount so distributed. This tax shall be an incidence on the company and shall not be passed on to the shareholder*”. Thus, the then moderate rate of 10% has almost doubled with an effective rate of DDT resulting to about 20%.

- The earlier DDT rate of 10% was comparative in line with the rate of TDS on dividends in most Indian and international tax treaties. The increased basic DDT rate of 15% (effective rate of about 20%) reduces the dividend distribution ability of domestic companies and the uncertainty with respect to its credit in overseas jurisdictions impacts the non-resident shareholders adversely.
- Currently, DDT is also levied on undertakings engaged in infrastructure development which are eligible for tax benefit under Section 80-IA. This is detrimental to the growth of infrastructure facility in India.

Recommendations

- All dividends on which DDT has been paid, be allowed to be reduced from dividends irrespective of the percentage of equity holding keeping in mind that investment companies which do not necessarily own/have subsidiaries as they invest in various companies in the open market, be also made eligible for

such benefit.

- The proviso to Section 115-O(1A) provides that the same amount of dividend shall not be taken into account for reduction more than once. The levy of DDT at multiple levels has been a subject matter of grievance by corporates. A part of this issue has been resolved by providing in the Act that if a holding company receives dividend from its subsidiary, a further distribution of dividend by the parent will not attract levy of DDT. Promoter holdings in operating companies are not necessarily in a single parent. Also, irrespective of whether there exists a parent-subsidiary relationship, a tax on dividends which have already suffered levy of DDT amounts to multiple taxation which should be avoided. It is therefore suggested that dividends which have suffered DDT be treated as pass through and be not subjected to levy of DDT.
- The tax rate of DDT is recommended to be reduced to 10% from the current effective rate of about 20% (after including the education cess, surcharge and grossing-up of the dividend).
- To incentivise the investment in infrastructure sector, it is recommended that DDT on industrial undertakings or enterprises engaged in infrastructure development, eligible for deduction under Section 80-IA, should be abolished. It is also recommended that further exemption from DDT be granted to the 'infrastructure capital company/fund' with the condition that it invests the dividend received from its subsidiary in the infrastructure projects.

2.4 Phasing of exemption/incentives vis-à-vis industry needs

The Finance Minister while introducing the Finance Act, 2015, proposed to reduce the rate of Corporate Tax from 30% to 25% over the next 4 years. It was also stated that the process of reduction has to be necessarily accompanied by rationalization and removal of various kinds of tax exemptions and incentives for corporate taxpayers, which incidentally account for a large number of tax dispute.

However, the process of phasing out of exemptions and deductions should not be on a lock stock barrel basis across sectors. There are various sectors where the turnaround time for the companies to reach a break even and start earning profits takes longer than some other industries. For e.g. infrastructure sector would take long for the completion of projects. The Government and health care sectors as well have long gestation periods. There would be certain entities which would have recently commenced commercial operations, will have to tackle phasing out much faster than anticipated and planned. Thus, the phase out of deductions and exemptions should be applicable in a selective manner more so in line with the on-going 5 year plans and beyond that which would consider the sensitivity of various industries.

2.5 Tax Incentives and Benefits - Section 35AD

2.5.1 Profit linked incentives for specified industries vis-a-vis investment-linked incentives - Section 35AD

Section 35AD extends investment linked incentives to taxpayers with respect to the capital expenditure incurred for setting up and operation of specified businesses. Further, once investment linked incentive for the capital expenditure is availed under this Section, no benefit shall be allowed in respect of such specified business under Chapter VI-A (Deductions in respect of certain incomes) and Section 10AA.

Issue

- Deduction under Section 35AD is an alternate form of accelerated deduction for the capital expenditure in the specified business. However, the cash flows of these capital intensive industries suffer on account of levy of MAT. This is because book profits continue to be higher than taxable profits (given that deduction for capital expenditure is not taken to the profit and loss account other

than in the form of depreciation) and hence, MAT is paid by the industry during the incentive period. While MAT is creditable against normal taxes in future, the period for recovery of MAT paid could result in being longer than under profit linked incentives. Further, given the restriction on the years for carry forward of MAT, it is possible that MAT paid in initial years may not be recovered, especially for those taxpayers who have a longer period before reaching break-even.

Recommendations

- The profit-linked incentives currently available for infrastructure and crucial sectors for e.g. enterprises engaged in Special Economic Zone, hotels and business convention centres in specified areas, etc. should be expanded to sectors such as retail and be continued till the end of 12th Five Year Plan i.e. till 2017 to encourage investment and growth of India's infrastructure sector.
- With the governments 'Make in India' campaign, there would be a need to bring under the ambit of deduction of Section 35AD more sectors to further strengthen the industrial base of the country, for e.g. the steel industry being a high capital intensive industry, capital expenditure should be allowed as a deduction on the amount of expenditure incurred.
- It should be considered to do away with MAT for the infrastructure industry as levy of the same defeats the very purpose of extending tax incentives to the industry, especially given the high rate of MAT now.

2.5.2 Dilution of tax incentive under Section 35AD by insertion of Section 73A

Issue

- The underlying idea behind allowing the investment linked incentive granted under Section 35AD is to enable the taxpayer to set-off the business losses incurred by this write-off against the taxable profits from their existing businesses and reduce their tax liability in the year of deduction and thereby to provide part of the resources of investment required for setting up of the businesses. However, the incentive so intended cannot be achieved owing to the insertion of Section 73A, which restricts the set-off/ carry forward of losses by specified business only against the profits and gains, if any, of any other specified business carried on by the taxpayer in that AY and the amount of loss not so set-off can only be carried forward and set-off against profits from specified business in the subsequent AYs.

Recommendation

- The losses from the specified business under Section 35AD ought to be made eligible for set-off against profits from other businesses of the taxpayer, and not restricted to be set-off against only the specified businesses, as it is not always the case that the taxpayer would only be carrying on the 'specified business'. In light of the above, Section 73A should therefore be deleted.

2.5.3 Clarification on amendment to Section 35AD(3)

Issues

- The amendment to Section 35AD(3) introduced by the Finance Act, 2010, seeks to prevent a taxpayer from claiming dual deduction in respect of the same business.
- It appears that if a taxpayer carrying on a specified business does not claim deduction under Section 35AD, he may opt for deduction under the relevant provisions of Chapter VI-A or Section 10AA, if the same exist for such business and it is more beneficial.

Recommendations

- A clarification should be issued that the taxpayer may exercise an option (where available to the taxpayer) to avail tax incentive under Section 35AD or Chapter VI-A/ Section 10AA, depending upon which is more beneficial to the taxpayer.
- Further, it is suggested that a clarification may also be issued that in the event the taxpayer opts for the investment linked incentive under Section 35AD and the same is denied/ rejected at time of assessment proceedings (could be on account of non-satisfaction of prescribed conditions), in such a case the taxpayer should be eligible to make an alternative claim under Chapter VI-A or Section 10AA, on satisfaction of the conditions provided therein, notwithstanding the requirement stipulated in Section 80A(5) or 10AA . This is because, a taxpayer who is otherwise entitled to deduction in respect of qualifying profits of the specified business would lose such deduction on account of Section 80A(5) that mandates a claim for deduction under chapter VI-A be made in its return of income. As the taxpayer would not have claimed deduction under the provisions of Chapter VI-A/ Section 10AA in its return of income since claim was made under Section 35AD , such taxpayer would be precluded from claiming deduction in view of Section 80-A(5)/ Section 10AA .

2.5.4 Investment linked tax incentive under Section 35AD is a restrictive tax incentive

Issues

- Section 35AD extended investment linked tax incentive to a taxpayer engaged in building and operating anywhere in India a 2-star or above category hotel. The same is a restrictive tax incentive to the industry as only such taxpayers are eligible which are engaged in both building and operating the hotel. Similar restriction exists for the hospitals, wherein the tax incentive is available for 'building and operating' anywhere in India a hospital with at least 100 beds for patients.'
- The Finance Act, 2012 w.e.f. 1 April 2011, introduced a new Sub-Section (6A) , which extended investment linked tax incentive to a taxpayer engaged only in 'building' hotel (and transferring the operation to another person). However, similar benefit was not extended for taxpayer engaged in building hospital.
- As can be seen from a plain reading of Section 35AD, it appears that the benefit under the Section would not be available in case the person building the hospital is different from the person operating it. This does not seem to be in harmony with the objective, specifically given the typical operating structure of the industry wherein very often the developer or builder of the hospital is different from the taxpayer who is operating and managing the hotel/ hospital. Considering the said anomaly was removed by the Finance Act, 2012 vide Section 35AD (6A) for hotel industry by granting investment incentive to a builder (though not operating the hotel), similar benefit ought to be extended to a hospital industry.
- Further, if a person does not build the hotel/ hospital, but acquires the same by purchase or rent or otherwise for purposes of operation and management thereafter, such taxpayer would not be entitled to the benefits of this Section.
- If any asset for which such deduction is allowed, is used for other than the specified business, before the period of eight years after the asset acquisition, then such deduction allowed, as reduced by the amount of depreciation allowable as if no deduction under this Section was allowed, shall be deemed to be the business income of the taxpayer of the FY in which the asset is so used.
- Currently, there are no benefits available for rural/ semi-urban healthcare infrastructure (other than for building and operating hospitals with at least 100 beds under section 35AD).

Recommendations

- For the hotel sector, the following clause is recommended to be replaced:
“(aa) on or after 1st day of April, 2010, where the specified business is in the nature of building or operating or building and operating a new hotel of two-star or above category as classified by the Central Government.”

Similar amendment is also recommended for the hospital sector as follows:

“(ab) on or after 1st day of April 2010, where the specified business is in the nature of building or operating or building and operating a new hospital with at least one hundred beds for patients”

- Consequential amendments should also be considered in clause (iv) and (v) of sub-Section (8)(c) of Section 35AD .
- The condition of non-transferability of the asset should be reduced to at least four years since even usage of the asset for four years indicate that the taxpayer intended to use the asset for the specified business. Higher period of non-transferability puts restriction on the transfer of independence of the taxpayer’s business decision and therefore, will prove to be counter-productive to the business growth.
- It should be clarified that if an asset is not used for the specified business due to obsolescence, etc. and at the same time not used in any other business, then the deduction allowed under this Section shall not be reversed.
- It is recommended that the weighted deduction of 150% be extended and made generally applicable to the entire list of business covered in the Section 35AD since all the said businesses are extremely important for the Indian economy like natural gas/ crude pipe line distribution, hotels etc. This would help to remove the discriminatory tax treatment between various specified businesses.
- It is suggested that a weighted deduction for healthcare infrastructure expenditure (other than hospitals) incurred in rural/ semi urban areas should be also provided.

2.5.5 Extension of Investment linked incentives under Section 35AD of the Act to telecom tower sector.

Issues

- Telecom tower sector is a capital intensive sector, similar to oil/g pipelines, hotels; hospitals etc. and hence, deserve equitable tax treatment with these sectors.
- Tax incentives by way of exemptions and deductions are designed to create economic security, promote asset creation, accelerate the pace of industrial production, provide employment opportunities, remove regional imbalances and provide social welfare. With this intention in mind, the concept of investment-linked incentive was introduced vide the Finance (No.2) Act 2009 by inserting Section 35AD of the Act.
- Owing to significantly high cost of setting up and maintaining networks, the telecom operators have stated following the infrastructure sharing model. This has led to birth of telecom tower service industry.
- The telecom infrastructure service industry is hugely capital intensive and comprises of capital investment on towers, green shelters, DG sets, air-conditioners, power Management Systems (PMS), Battery Banks, UPS etc. Tax benefits under section 35AD shall lower the cost of services offered and would thus help in achieving the Government's goal of providing affordable telephony.

- Such tax benefits would also increase rural penetration resulting in enhanced coverage and an avenue of growth. It would also provide better economies of scale as compared to the present model.

Recommendations

- Inclusion of telecom sector in the definition of “specified business” under section 35AD(5). Further, the said benefit should be granted to installation of plant and equipment’s on new towers and for replacement of plant and equipment’s on existing towers.

2.6 Tax Incentives – Weighted deduction under Section 35(2AB) and 35(1)(ia)

Issue

- In the pharmaceutical Sector, discovery is a lengthy, risky and expensive proposition. In this business environment, necessitated by the current business needs, sometimes companies incur expenditure towards scientific research outside their Research & Development (R&D) facility for e.g. expenditure incurred outside the approved R&D facility towards clinical trials (including those carried out in approved hospitals and institutions by non-manufacturing firms), bioequivalence studies conducted in overseas CROs and regulatory and patent approvals, overseas trials, preparations of dossiers, consulting/ legal fees for filings in USA for new chemical entities (NCE) and abbreviated new drug applications (ANDA) as approved by the Department of Scientific and Industrial Research (DSIR) which are directly related to the R&D, etc.

Recommendation

- It is recommended that the existing provisions should specifically allow weighted deduction in respect of expenditure incurred outside the R&D facility which are sometimes necessitated by the industry's business needs. Additionally, it could be clarified that where the risk of doing research is assumed by a company, the entire cost of R&D activities (whether outsourced or undertaken in-house) is eligible for weighted deduction in the hands of company undertaking the risk.

Issue

- Currently, there is no clarity whether a company engaged in the business of development and sale of software or providing IT or Information Technology Enabled Services (ITES) services, is eligible for weighted deduction on the R&D expenditure incurred by it.
- As per DSIR guidelines amount spent by a recognized in-house R&D unit towards foreign consultancy, building maintenance, foreign patent filing etc. are not eligible for weighted deduction under Section 35(2AB). Such expenditure are essential in carrying out research at the approved R&D centers.

Recommendation

- Provisions should be introduced in the Act, to provide that DSIR can approve the R&D facilities of the companies engaged in the development and sale of software. It is recommended that weighted deduction for R&D expenditure should be extended to service sector as well.
- It is also recommended that DSIR guidelines need to be modified accordingly to specifically include expenditure (such as foreign consultancy, building maintenance, foreign patent filing etc.) for claiming weighted deduction under Section 35(2AB).

Issue

- The DSIR guidelines provide that eligible capital expenditure on R&D will include expenditure on plant, equipment or any other tangible item only. It also provide that capital expenditure of intangible nature is not eligible for weighted deduction.

Recommendation

- It is recommended to provide weighted deduction for expenditure incurred on internally developed intangible assets under Section 35(2AB).
- It is also recommended that any initial cost paid for acquiring R&D related intangible assets, which are used in the R&D unit should also be allowed for weighted deduction under Section 35(2AB).

Issue

Whether DSIR has the authority to decide quantum of R&D expenditure entitled to weighted deduction under Section 35(2AB)?

Recommendation

- The provisions, the Rules and DSIR guidelines do not expressly provide whether DSIR has the authority to decide quantum of R&D expenditure entitled to weighted deduction under Section 35(2AB).
- It is recommended that an amendment in the Act should be made to clarify that the DSIR is not the authority to decide the quantum of R&D expenditure. The AO is duty-bound to decide the quantum of R&D expenditure which is eligible for weighted deduction as per Section 35(2AB) read with Rule 6 of the Rules.

Issue

- Section 35(2AB) has been gradually amended to provide increased tax benefits on expenditure incurred towards in-house R&D facilities i.e. from 125% to 200%. However, Section 35(1)(ia), which provides tax incentives in respect of payments made to R&D company, has remained same at 125%. The conditions specified by the DSIR for grant of approval for a recognized R&D facility/ company under Section 35(2AB) and Section 35(1)(ia) are the same and hence, the tax benefits provided under Section 35(1)(ia) should be at par with the tax benefits provided under Section 35(2AB).

Recommendation

- It is recommended that the tax benefits under Section 35(1)(ia) should be increased to 200% from the present level of 125%.

Other recommendations

- Presently, there are no specific provisions which enable carry forward of R&D benefits separately. Considering the time taken in R&D activity, and its benefit available after a very long gap, it is suggested that the unutilized R&D deduction should be available for carry forward and set off indefinitely (as in the case of unabsorbed depreciation).
- Benefits in the form of research tax credits which can be used to offset future tax liability, similar to those given in developed economies can also be introduced.

2.7 Definition of Association of Persons to be modified - Section 2(31)

Issues

- The term Association of Persons (AOP) has not been defined in the Act. As per Section 2(31), 'person' includes, inter-alia, association of persons or body of individuals, whether incorporated or not. Explanation to Section 2(31) further provides that an AOP shall be deemed to be a person, whether or not such person or body was formed or established or incorporated with the object of deriving income, profits or gains.

- Since the definition is not provided by the statute itself, one has to refer to the legal jurisprudence for understanding the meaning of term 'AOP' which results in unwarranted litigation and subjectivity. The Delhi High Court in the case of Linde AG, Linde Engineering Division and Anr vs DDIT 365 ITR 1 (Del) 2014 held that apart from presenting a 'common face' as members of a consortium, high level of common management, element of mutual agency and joint action for mutual purpose is also necessary to form an AOP. The essential characteristics of an AOP flowing from the various judicial precedents including this recent decision can be illustrated as follows:-
 - Two or more persons join together or associate together;
 - The parties should come together out of their own free will (out of volition);
 - The association should be for common purpose or common action;
 - Mutual rights and obligations;
 - Incurrence of common expenditure;
 - There should be joint execution and/ or supervision of the work;
 - Possibility of reassignment of work amongst members;
 - Some kind of scheme for common management.
- Whether an AOP is constituted or not would have to be decided on a conjoint reading and analysis of the above factors to the facts and circumstances of the case. No one factor can be said to be decisive for determining AOP and the priority of the factors is also not laid down in law.

Recommendation

- It is suggested that the term AOP may be appropriately defined to lay down the essential aspects for constituting an AOP by way of some guidelines. This would provide some certainty and help to reduce litigation for the consortiums formed by non-residents to execute contracts in India.

Issues

- A large number of big infrastructure contracts are awarded by Public Sector Undertakings/ Government companies to non-residents. Many developers also require contractors to bid in a consortium with a view to ensure that specific components of the project get executed by an earmarked contractor who has requisite capabilities in this regard and yet, derive the comfort that the entire project (comprising of several parts) will be successfully commissioned by the consortium of contractors, although each contractor will be executing its specific part only. The consortium members/ contractors undertake their respective scope of work separately/ independent of each other and do not share profits/ losses with each other. Further, there is a separate consideration earmarked for each contractor and the payment is made directly to respective contractor by the customer. Thus, contractors enter into consortium and agree to jointly undertake the work for better co-operation in their relationship with the developer/ provide comfort to developer and for no other purpose. Consequently, the intention behind consortium/contract split arrangements is never to constitute a partnership/AOP but to meet the business requirements of the developer.
- With a view to provide clarification in this regard, CBDT had issued instruction no 1829 dated September 21, 1989, wherein, it was clarified that companies forming the consortium for execution of power projects on turnkey basis will not constitute an AOP under the Act and offshore supply of goods by non-resident contractors engaged in execution of turnkey projects shall not be liable to tax in India, if the title to the goods is transferred outside India. However, in the year 2009, the said instruction was withdrawn on account of misuse of such instruction by various non-residents.

- The principles outlined in the aforesaid instruction have also been accepted by the Supreme Court in the case of Ishikawajima-Harima Heavy Industries Ltd and Hyundai Heavy Industries Co. Ltd. (2007) 161 Taxman 191 (SC). Further, Delhi High Court in the case of Linde AG, has also followed the aforementioned principles and held that offshore supply of goods by non-resident contractors are not taxable in India, if the title of such goods is transferred outside India. The HC further held that if the offshore services are inextricably linked to such offshore supplies, then such services are not taxable in India.
- However, the Revenue Authorities are taxing such non-residents as AOP at the withholding tax/ assessment procedure stage on the basis of a few favourable AAR rulings and withdrawal of the abovementioned circular. Further in this regard, there are various tax complexities that are associated with assessments of AOP, including double taxation of non-residents in India and their country of residence (with no possibility of double taxation being avoided). The said position of the Revenue Authorities is causing hardship to the industry and is also resulting in pessimism as regards the uncertain tax environment in India. Large amount of working capital is also getting blocked up in TDS/ payment of tax demands consequent to completion of assessments.

Recommendation

- Without prejudice to the above recommendation with regards to the issuance of guidelines, it is recommended that the aforementioned instruction should be reissued and the clarification be made applicable to the infrastructure sector and Engineering Procurement and Construction contracts. The reissuance of the “1989 clarification” would go a long way in instilling confidence amongst the non-resident contractors as regards the stability/ fairness of the Indian tax regime, which, in turn, would also encourage non-resident contractors to set up their manufacturing hubs in India and thereby result in a multiplier effect on the Indian economy.

Issue

- As per Section 86, share of the member in the income of an AOP is not includible in total income of the member. However, such income is not excluded while computing the MAT liability of the member, unlike in the case of a partner of firm whose share in the profits in the firm is exempt in the hands of the partner as per Section 10(2A) and no MAT is payable by the partner on such profits under Section 115JB . The reference to Section 86 in Section 115JB is missing. It is unfair to have such a discriminatory tax treatment between a partner of a firm and a member of an AOP.

Recommendation

It is recommended that Section 115JB should be amended to specifically provide that the share of income of a member from an AOP, which is otherwise exempt under the provisions of Section 86, should be excluded while computing the liability of the member under 115JB.

2.8 TDS on monthly provision entries and year end provision memorandum entries

Year-end provisions are made by assesseees to follow accrual system of accounting. As per the current tax regime, tax is required to be deducted on such provisions which often leads to excess deduction and deposit of tax, disputes with the vendor and unnecessary burden posed due to extensive reconciliation.

Relief from deduction of tax at source should be given on payments that are accrued but are not due to the payee and for which the payees are not identifiable and represents only a provision made in accordance with accounting policy.

2.8.1 Clause 34 to Tax Audit Report – Details of Tax deducted at Source

Issues

- During reporting for last fiscal year i.e. financial year 2013-14 corresponding to AY 2014-15, CBDT had notified new reporting format for tax audit u/s 44AB. One of the salient changes relates to extensive reporting in respect of tax deducted at source. The report mandates reconciliation of expenses booked in the accounts to amount on which taxes have been deducted at specified rates / rate as per certificate along with reasoning in respect of amounts on which tax has not been deducted.
- Reconciliation of expenses booked in accounts to TDS return along with reasoning as to why TDS has not been deducted is virtually impossible to perform more specifically in case of large organizations where expenses run into thousands of crores. The new format casts onerous burden on taxpayers and may not lead into any additional benefit than waste of significant time and resources. The erstwhile reporting format duly takes care of the details required by the taxpayer and is certified by the tax auditor by duly verifying all the details.

Recommendation

- The reporting in respect of tax deducted at source should be reverted to same as was existing until financial year 2012-13.

2.8.2 TDS on Telecom Payment

Issues

As per Explanation 6 to Section 9(1)(vi) of Income-tax Act, 1961 ('the Act'), it is clarified that "the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fiber or by any other similar technology, whether or not such process is secret."

Accordingly, use of process (which includes transmission as above) would qualify as 'Royalty' under section 9(1)(vi) of the Act the payment of which would be subject to tax withholding under section 194J of the Act.

Recommendation

Suitable instructions may be issued by the Central Board of Direct Taxes, to provide clarity on the scope of applicability of the provisions of Section 9(1)(vi) read with Section 194J of the Act on telecom payments within India. This can save on avoidable litigation cost and would add to the ease of doing business in India.

2.9 Tax Administration Reform Commission (TARC)

The TARC, constituted to examine and suggest reforms focusing primarily on tax administration, has come up with some path breaking recommendations which should be given consideration. Accordingly, it is suggested that the following recommendations given by TARC should be implemented:

- Setting up of a dedicated organization (with resources and personnel) to deliver taxpayer services
- In redressing taxpayers' grievances, the decision of the Ombudsman should be binding on the tax officers.
- Various recommendations have been laid down by TARC to bring synergy between CBDT and Central Board of Excise and Customs (CBEC), so as to add value to the respective departments and also eliminate duplication of work. Large Taxpayers Unit (LTU) is a step towards this direction. However, it has not received adequate response. Therefore, it is recommended to lay down certain other measures which will bring synergy between CBDT and CBEC.
- Clarity in laws and procedures, timely intervention by the CBDT to clarify contentious matters, avoidance of tax demands which are not on merits, pre-dispute consultation, proper control over quality of show cause notices/ demands/ questionnaires issues to the taxpayers and an approach to resolve conflicts before conclusion of audits.
- Current practice of raising demands irrespective of merits should be discontinued. Pre-dispute consultation should be followed as a practice before issuing tax demand notice.
- Strict time frame for granting of refund, guidelines for grant of foreign tax credit etc. are recommended.

2.10 Section 72A - Carry forward of business losses pursuant to approved Merger/ Amalgamation.

Background

- Section 72A of the Act allows accumulated losses of amalgamating company to be carried forward and set off in the hands of the amalgamated company. Currently, the carry forward of losses is limited to industrial undertakings or a ship, hotel, aircraft or banks. The term industrial undertaking has been defined to include the companies which are engaged in the business of providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, and network of trunking, broadband network and internet services.

However, the telecom infrastructure service providers are presently not included.

Issues

- The benefit of Section 72A was introduced to telecom operators in FY 2002-03 with a view to encourage rapid consolidation and growth in telecom sector. At that time, each telecom operator used to set up its own telecom towers to cater its own need of passive infrastructure (i.e. telecom towers, shelters, power back up) services. Accordingly, the concept of Telecom Infrastructure Service Providers (TISPs) was not envisaged in FY 2002-03 when the benefit of Section 72A was extended to telecom sectors.
- Considering that passive infrastructure industry is integral and inseparable from telecom industry and has also been conferred the status of infrastructure, an amendment under section 72A is desired to the effect that the brought forward business losses of the amalgamating telecom tower companies shall be allowed to be carried forward with the amalgamated telecom tower companies.

Recommendation

- It is recommended to include the ‘Telecom Infrastructure service providers’ in order to provide the benefit of carry forward of business losses under section 72A in the cases of mergers and amalgamations. As telecom tower industry is an integral and inseparable part of telecom services, the specific inclusion will bring parity for the tower companies with telecom operators and other key industrial sectors.

2.11 Inclusion of telecom tower infrastructure service in the definition of Infrastructure facility in Section 80IA of Income Tax Act.

Background

- Section 80IA of the Act provides income tax benefits on profits from operating, developing and maintaining infrastructural facilities such as roads, highways, water supply project, ports, airports etc. The telecom operators were also eligible for the benefit under section 80IA till 31 March, 2005 as it is a capital intensive sector and required tax benefits in its early stages.

Issue

- The telecom sector is a critical infrastructure for economic growth of the country and has a direct multiplier effect on the GDP. The telecom infrastructure sector has evolved over the years and is the backbone of the telecom sector at large. Government of India (GoI) has conferred ‘Infrastructure industry status’ to the industry.
- This clearly puts telecom infrastructure sector at par with road, highway project, water supply project, ports, airports in terms of importance for the Indian economy.
- This will lower the cost of services offered by telecom tower sector and provide funds to reinvest into capital expenditure to be incurred on a regular basis. It would thus help in achieving the Government's goal of providing affordable telephony.

Recommendation

- It is recommended that the telecom infrastructure service industry, being highly capital intensive and in its early stages of growth, should also be extended similar tax benefit. Further, the said benefit should be granted to income from existing towers as well as new towers.

2.12 Accelerated Tax Depreciation rates on Batteries for industrial/commercial use.

Issues

- The higher usage of batteries at telecom sites ensures cleaner and environmentally friendly power with no carbon emission as against use of diesel in DG sets for power back up. The accelerated depreciation on batteries for industrial use will reduce the effective cost of batteries for buyers and thereby, help in reducing diesel consumption. This in turn helps country to reduce oil imports and foreign exchange outflow.
- The depreciation rates under the Income-tax Act have often been designed keeping in mind the effective useful life of the assets. For Example computers enjoy 60% depreciation due to accelerated obsolescence due to ever changing technology.
- The objective of allowing depreciation is to provide funds for replacement of assets and also, to ensure recovery of cost of original asset. In the context of rapidly changing technology and increasing obsolescence, the present depreciation rates allow only 38.6% cost recovery in 3 years of economic life of batteries.

Recommendations

- It is recommended to Increase the depreciation rate to 65% on batteries used by telecom infrastructure service so that approx. 95% cost can be depreciated over 3 years.

2.13 No processing of tax refunds if tax return is selected for audits

Issues

- With this CBDT instruction, now such refunds can only be processed after completion of tax audits. The time lag for such completion of tax audits would be between 2-3 years.
- This is a very negative provision which directly hampers the cash flow of the tax payers during such economic crisis.

Recommendations

- It is suggested to process the tax refund in timely manner and must not be linked with the completion of tax audits per se, if at all Government wants to still pursue this instruction then the tax refunds can at least be processed after analysing the previous tax audit history of the tax payer after introduction of internal time bound rationale approval mechanism.

2.13.1 Section 244A – Specifying time limit for grant of refund along with interest

Issues

- Section 244A of the Income-tax Act provides for interest @ 0.5% p.m. on refund due from first day of April / date of payment till the date of grant of refund.

- However, no time limit has been provided within which an authority shall grant refund to a taxpayer resulting in inordinate delays extending to more than 5-10 years in many cases.
- Refunds legitimately due to taxpayers are withheld illegitimately by either not passing an order / order effect or not actioned upon after passing an order. In many cases, the inordinate delay ranges from 5 to 10 years or even more. This results in exchequer bearing the interest burden u/s 244A for inaction by tax authorities. To add, the rate of interest is a measly 0.5% p.m. which does not even take into account the inflation and time value of money lost by a taxpayer in the process.
- In spite of CBDT advising tax authorities by way of Circular or Citizen Charter to pass order effect / grant refunds within a minimum time frame of 1 month / 6 months respectively, such Circulars / Charter remains only on paper and never followed in practice.
- On the contrary, when there is a demand pending to be paid by the taxpayer, the same tax authority swings into action and resorts to all options available under the sun, whether within the rule book or otherwise, including coercive measures to collect tax promptly.
- To make matters worse, failure on part of a taxpayer to pay a demand attracts interest @ 1% p.m. whereas if the amount is due by a taxpayer, the rate of interest is 0.5% p.m. This amounts to unjust enrichment by the exchequer at the behest of hapless taxpayers who are stuck in the administrative delays and inaction by tax authorities.
- Section 234D enables the tax authorities to collect interest @ 0.5% p.m. if a refund made to an assessee turns into a demand subsequently. Therefore, there is no loss to the exchequer by granting timely refund to the taxpayers. If the intention was not to grant refund along with interest timely or grant the same only after passing an order / order effect, then the provisions of Section 234D are rendered otiose and shall be struck down from the Act.

Recommendation

- To ensure transparency and adhere to Citizen Charter in practice, the relevant provisions of the Act be suitably amended to provide for a mandatory time limit of 1 month within which the tax authorities are obligated to pass an order effect suo-moto without the taxpayer making an application in this behalf.
- Furthermore, Section 244A should be amended to provide that refund along with interest, as may be applicable shall be granted within a mandatory period of 6 months from the date when they become due.

The aforesaid shall result in huge savings to the exchequer in form of interest which are generally payable due to inaction and administrative delays on part of tax authorities without any moral obligation / being held responsible for the same.

2.14 Income Tax Return Forms for FY 2014-15 along with uncalled for enlarged scope of foreign asset reporting requirement.

Issues

- Government of the day has again introduced a sweeping uncalled for tax law change by way of introduction of new Income Tax return form in April 2015 which in fact a retrospective change (being applicable from April 1, 2014) with all related provisions pertaining to information required in such new tax return forms
- The uncalled for provisions especially pertaining to foreign asset reporting are as under:-
 - 1 Definition of owner for foreign assets and income has been widened to include beneficial owner or beneficiary
 - 2 Date of opening foreign bank account – this reporting will be difficult for age old accounts,
 - 3 for any foreign asset reported, taxpayer needs to disclose date of acquiring of such asset,
 - 4 details of income earned (including exempt income) from such asset,
 - 5 amount that has been offered to tax in India and where such income has been reported

Reporting of these details poses a great challenge to segregate income from assets acquired at different dates (e.g. dividend income earned from shares of the same company but acquired on various dates).

- Challenge for Tax Residency Certificate (“TRC”):

Government had made TRC a mandatory requirement to claim double taxation avoidance agreement (‘treaty’) relief in India tax return, however, in the ITR forms notified for FY 2014-15, there is a mandatory requirement to confirm availability of the same with respect to income from other sources taxable at special rates, and capital gains not taxable in India.

This uncalled for amendment poses a great challenge for the expatriate community because TRCs are generally not available at the time of filing of India tax returns, due to different filing timelines in various jurisdictions.

Hence, availability of the TRC has to be perforce mentioned as ‘not available’ in the tax return, which may lead to queries/ notices from the revenue authorities.

The revised ITR forms also provide a relaxation for non-reporting of foreign assets in cases where the assets were acquired in the year when the taxpayer was a non-resident in India and no income is earned during the FY 2014-15 from such assets. However, this relaxation should be extended going forward also.

Recommendations

- It is recommended that Government must not resort to such ‘retrospective changes’ in tax laws which are impacting international community. Such retrospective changes are always discomfoting for the international community which is looking for stable tax environment in India.

- The unreasonable information pertaining to foreign assets reports should be withdrawn as introduced changes lack practical approach, especially when Government has introduced very aggressive blank-Money Act in India
- The TRC requirement in the new forms must also be relaxed and the same may be filed by the expatriate when availing the double taxation treaty benefit.

2.15 Introduction of ICDS (Income Computation and Disclosure Standards) from April 1, 2015.

Issues

- ICDS in current form are having some inherent issues which need clarification from Government at the earliest. There is tremendous fear in tax payers that such halfhearted and hurried approach of Government to introduce ICDS would increase unwarranted litigation in times to come. The fear among the tax payers are as under:-
 - (a) Taxes would be levied on Income which actually not earned,
 - (b) Deduction of expenses may be denied negative age old principle of prudence / conservatism.
 - (c) Significant increase in compliance cost pertaining to reconciliation between book profit and taxable income,
 - (d) Increased litigation and uncertainties, contrary to stated objectives of ICDS,
 - (e) Adverse effect on MAT credit.

Recommendation

- It is strongly suggested that Government must come out with detailed clarity on ICDS by way of guidance note with the intent to eliminate any possible future litigation which is in line with stated objectives of ICDS

2.16 Corporate Social Responsibility Costs

Issues

- Corporates are currently involved in various areas of social responsibility/community development as part of nation building. Further, the concept of Corporate Social Responsibility Costs has been introduced under Companies Act, 2013. The expenditure is mandatory in its nature and as such it is a statutory levy. Accordingly it deserves tax deduction. Even though it may be covered under Section 37 it deserves for a specific section in Section 36. Allowing tax deduction may encourage corporate to incur expenditure more than minimum prescribed limit. Providing suitable tax incentives in respect of such Corporate Social responsibility Costs to accelerate the process and to ensure that the country can reach the goal of being a developed nation in the near future is the need of the hour.

Recommendation

- a) A deduction of the expenditure on community / social development (both capital and revenue) be introduced, specifically covering critical areas like education, health, animal husbandry, water management, women empowerment, poverty alleviation and rural development.
- b) Even in cases where a company has its own trust or foundation, the deduction in respect of expenditure incurred for CSR activities should be allowed.
- c) Such expenses, however, should be subject to a limit say 5% of total income.
- d) CSR expenditure is allowed by way of donation to Prime Minister Relief Fund/ Trust registered u/s. 80G/ associations approved u/s. 35AC. If deduction of CSR expenditure is not allowed, this shall be discriminatory for those corporates, who may like to carry out CSR activities on their own.

2.17 234E: Levy of fee in case of delay in filing of TDS or TCS statement.

Issues

- Provision need to be deleted
- Alternatively (i) fees shall not be levied if there is reasonable cause for failure filing of statement u/s 200(3) and 206C (3). (ii) Further the amount of fees be reduced to Rs.100 rupees per day.

Recommendation

- Though it is termed as fee it is of a penal nature and is mandatory. Even if a person is prevented by reasonable and sufficient cause for not submitting TDS statement on time, he will be liable for fee of Rs.200/- per day and in addition to this the deductor may be liable to interest as well as penalty leviable under the proposed new penal provision of section 271H and the mechanism of making the payment first and then submitting the quarterly statement to NSDL is not practical workable.

2.18 271H: Penalty for filing incorrect particulars or failure to file TDS or TCS Statement.

Issues

- This provision need to be deleted; Alternatively
- The minimum amount of penalty be reduced from Rs.10,000 to Rs.5000 and maximum amount of penalty be reduced from Rs.100,000 to Rs.25,000.

Recommendation

- Above provisions are very harsh since deductor or collector needs to also pay interest on delayed payment of TDS/TCS, additional Fees of Rs.200 per day and further penalty u/s 271H.
- Further it also tries to levy penalty for furnishing incorrect statement of TDS / TCS. As you all are aware that TDS and TCS statements are to be “E filed” every quarter and in a specified format which itself is a tedious process and in process of filing statement any data punching errors made by a person filing TDS/TCS return shall also be punished. Thus this will build additional pressure on the deductor/ collector and increases cost of compliances tremendously.

2.19 Uploading of erroneous demands on CPC databases, inaction in respect of pending rectification applications and adjustment of erroneous demands against refunds of later years.

Issues

The tax payers have generally observed such heart burning issue:-

- a. No action has been taken in respect of pending rectification applications u/s 154 of the Act. Moreover, pending demands have been uploaded on the CPC database and adjusted against the pending refunds of the assesseees.

b. In cases where the rectification has been carried out and the demands have been nullified / reduced / cancelled, the information is not updated on the CPC database and demands are continued to be shown as pending and adjusted against the legitimate refunds due to the assessees.

c. Refund orders have been passed but the actual refunds are not granted and there is considerable delay in many cases.

Recommendation

- It is suggested that a proper action plan should be laid down by the CBDT and all the field officers should be instructed to carry out the rectifications with in a time bound manner and same should be closely monitored by the senior officials of the department.
- After the rectifications, the erroneous demands uploaded on the CPC database should be forthwith updated and refunds should be granted to assessees in all such cases at the earliest possible.

2.20 Administration of tax deduction at source by Traces

Issues

- There are several issues in administering and processing of tax deduction at source by TRACES resulting in frivolous, inaccurate and frequent default notices issued upon the deductor.

Recommendation

- Complete overhaul of the TRACES system is necessary to consider and configure the provisions of the Income-tax Act relating to TDS in TRACES to minimise frivolous and inaccurate default notices issued upon the deductor.

These result in continuous and multiple follow ups with the TDS officers to get the default notices as well as inaccurate demands deleted.

2.21 Restraining adhoc disallowance by Assessing Officer during the course of assessment proceedings

Issues

- There is no specific mandate under the existing provisions empowering an Assessing Officer to make an adhoc disallowance purely on surmises and conjectures.

- Irrespective of the fact that there is no specific mandate under the law permitting adhoc disallowances, the same does not preclude an Assessing Officer to make adhoc disallowances without any reason whatsoever and without testing the same on touchstone of law. To make matters worse, the same continues to be blindly followed year on year resulting in un-necessary litigation which basis past experience suggests that Tax Department invariable loses.
- It shall be noted that a taxpayer gets his accounts audited under the provision of Companies Act wherein a statutory auditor examines the entire books of account and comments on the true and fair view of the state of affairs. The statutory auditor examines the books of account with reference to records maintained by the taxpayer and certifies the same. Over and above the statutory audit, the taxpayer is obligated to get a tax audit report from an accountant enabling the taxpayer to prepare his return of income. The same also acts as an aid to the Assessing Officer to complete the assessment.
- If an accountant furnishing the tax audit report has certified amounts to be reported under various clauses of the tax audit report, the same needs to be honoured by the Assessing Officer. Instead the Assessing Officers resort to full-fledged audit during the course of assessment proceedings questioning the amounts certified in the tax audit report resulting in significant waste of time and efforts on part of both the taxpayer as well as the Assessing Officer. If the intent of the tax audit report is to aid the Assessing Officer in completion of assessment, the aforesaid principle should be respected by the Assessing Officer.
- No gain is obtained if the Assessing Officer still questions a taxpayer on the amounts reported in the tax audit report which renders the entire exercise of obtaining tax audit report redundant. If the Assessing Officer is empowered to question all transactions reported in the audited accounts, then the obligation to obtain tax audit report should be done away with which results in involvement of significant time, efforts and resources by the taxpayer.

To conduct a meaningful assessment, recourse should rather be made to adjudicate issues involving legal principles / interpretation than resorting to adhoc disallowances of expenses / adhoc additions to income which have no legal standing of its own.

Recommendation

- Suitable amendment should be made in the law laying down that the Assessing Officer cannot resort to adhoc disallowances and has to respect the statutory audit and tax audit furnished by a taxpayer unless the situation warrants so.

- Even if disallowances are to be made, the same needs to be made only with reference to the provisions of the law without resorting to mere adhoc disallowances

2.22 Section 68 – Not to apply on receipt of share premium in excess of fair market value to which Section 56(2)(viib) applies

Issues

- Section 68 of the Act provides for taxability of unaccounted / unexplained money i.e. where nature and source of funds remained unexplained in respect of credit entries recorded in the books of account. Section 68 as amended w.e.f. April 1, 2013, also provides that in addition to the recipient, the person contributing to the share capital of a private or an unlisted company also has to explain the nature and source of funds.
- On the other hand, Section 56(2)(viib) of the Act provides that share premium received by an unlisted company upon issue of shares in excess of the fair market value shall be treated as income in the hands of such company and subject to tax accordingly. This law is applicable w.e.f. AY 2013-14.
- Recent newspaper reports suggest that Tax Authorities are seeking to invoke the provisions of Section 68 to transactions prior to April 1, 2013 by bringing the excessive premium to tax.
- Section 68 can be invoked in a situation wherein nature and source of funds remain unexplained by the recipient and the contributor. If the nature and source of funds stands explained, tax department could then have recourse under Section 56(2)(viib) only in situations where difference in technical aspect of valuation exist. However, the converse may not be true i.e. if Section 56(2)(viib) is invoked to tax the difference in technical aspect of valuation, the test of nature and source of funds stand automatically satisfied. The rigours of Section 68 should stop with the investigation into nature and source of funds and not extend to cater to the technical aspect of valuation dealt specifically under section 56(2)(viib) as the Legislature may not have intended to provide two sections i.e. Section 56(2)(viib) and Section 68 to be used interchangeably. Section 68 also cannot be invoked in cases of genuine issue of shares by a company to joint venture partners or financial investors i.e. private equity, venture capital funds etc.

Recommendation

- The provisions of Section 56(2)(viib) and Section 68 of the Act be suitably amended to provide safeguard against its invocation interchangeably. Only if the tests laid down under Section 68 do not stand to be fulfilled, section 68 can be invoked. Furthermore, once 56(2)(viib) has been invoked, then the test of Section 68 should be considered as automatically satisfied. The provisions of law should not be allowed to be used interchangeably.

2.23 Section 142(2A) – Volume of the accounts and doubt about the correctness of the account not to be a criteria for reference to special audit

- Section 142(2A) of the Income-tax Act has been amended vide Finance Act, 2013 to provide that volume of the account or doubt about the correctness of the account could also be one of the reasons for which the Assessing Officer may make a reference for a special audit by an accountant.
- Courts in the past have held that an Assessing Officer should form an opinion about the nature of accounts of a taxpayer is complex and the opinion should be formed objectively after an honest attempt has been made to understand the accounts. The contention that Assessing Officer is a layman and has no experience in dealing with accounts cannot be accepted. Only if the records are produced and accounts are examined, the complexity of the accounts can be ascertained.
- The guiding principle, therefore, for reference to a special audit was hinged on objectivity and complexity of accounts and not left at the subjectivity of the Assessing Officer. With the amendment brought vide Finance Act, 2013 the aforesaid principles seems to have been obliterated and left to the subjectivity of the Assessing Officer.
- Reference to special audit merely on the basis of volume of accounts would make the provisions applicable to almost all large corporates as no definition / threshold has been provided to construe what constitutes volume. Any manufacturing organization with 3-4 manufacturing locations or more would have voluminous nature of operations and shall attract the rigors of amended provisions of Section 142(2A). This would result in creation of fear psychosis in the mind of all large corporate groups as virtually all of them would be subject to special audit under the amended provisions if the Assessing Officer decides so.
- Moreover, due to the subjectivity element involved, it would be like providing free hand to Assessing Officers to shirk their responsibility in favour of the accountant seeking assistance in completion of assessment. Resultantly, the taxpayer would be burdened by committing additional time, efforts and resources to get the accounts audited over and above multiplicity of audits conducted under various Legislations i.e. Companies Act, Excise, Service tax etc. It would not be fair to burden the taxpayer with one additional audit because of the subjectivity of the Assessing Officer.

Recommendation

- Criteria linking reference to special audit merely on the basis of volume of accounts should be removed. Moreover, subjectivity element involved in doubt on the correctness of accounts should be suitably safeguarded by introducing factors / circumstances resulting in doubt on the correctness of the accounts.

2.24 **Securitization Trust**

Issues

The Explanation to section 115TC seeks to define various terms specified therein. Clause (d) of the said Explanation defines the term “securitization trust”.

The definition of securitization Trust given in section 115TC mandates the securitization Trust to fulfil certain conditions. As stated in the budget memorandum regarding delegated legislation, such conditions were supposed to be announced in the form of rules. The rules are yet to be announced

Recommendation

As CBDT is yet to issue the rules for the budget announced last year, section 115TC may be amended to delete the words “which fulfils such conditions, as may be prescribed” after sub clause (d) (ii).

2.24.1 Exclusion of dividend & income distributed by securitization trust for computation of disallowance under section 14A of the Act

Issues

- The dividend income and income distributed by securitization trust is not included in the total income of assessee and included for computing the disallowance under section 14A. However, the company/trust distributing such income is liable to dividend distribution tax/ additional income tax u/s 115TA. Thus, disallowance under section 14A on income, which has been taxed in the hands of the distributor but exempt in the hands of the recipient results in double point tax incidence in the hands of the recipient and leads to additional tax incidence for Indian industry. The securitization is thus rendered financially unviable for taxable entities like banks.
- The method prescribed in Rule 8D has increased the complexity already pervading section 14A and has resulted into increasing litigation. Such litigation may be avoided by simplifying the method of disallowance under section 14A.

Recommendation

- Dividend and income distributed by securitization trust be excluded for computation of disallowance as per section 14A
- Alternately, the dividend distribution tax/ ‘additional Income Tax’, as specified be treated as a withholding tax (i.e. TDS) for taxable entities eligible for set off against the normal tax liability.
- Section 14A disallowance at a fixed percentage say 2% of gross exempt income be prescribed under 14A.

2.25 Clarification on recharacterization of share buy-back transactions.

Issues

- Provisions of Section 46A section 2(22) of the Act, along with the Memorandum to the Finance Act, 1999 expressly clarify that the income arising to a shareholder on buy-back of shares was to be treated as income from capital gains and not dividend income.

Notwithstanding the above, income-tax authorities have, in several cases, sought to re-characterize the purchase consideration for buy-back of shares (undertaken prior to 1 June 2013) as dividends and accordingly, subjecting the amounts distributed by the Indian companies to dividend distribution tax ('DDT'), placing reliance on a decision of the Authority for Advance Rulings (AAR No P of 2010).

In this regard, it should be noted that the Finance Act 2013 introduced section 115QA in the Act (w.e.f 1 June 2013) to provide that any amount of distributed income by a company on buyback of unlisted shares shall be charged to tax and the company so distributing its income shall be liable to pay additional income tax at the rate of twenty percent of the distributed income. This makes it abundantly clear that prior to insertion of Section 115QA in the Act, the Parliament never intended to treat the gains received by a shareholder on account of buyback of shares as anything other than capital gains in terms of the provisions of Section 46A of the Act.

Pertinently, the above issue was also considered by the Shome Committee at the time of examining the General Anti Avoidance Rules ('GAAR'). In this context, the Committee observed that whether to pay dividend to its shareholder, or buy back its shares or issue bonus shares out of the accumulated reserves is a business choice of a company. Further, at what point of time a company makes such a choice is its strategic policy decision and such decisions cannot be questioned.

Recommendation

- Given the discussions, it is abundantly clear that prior to 1 June 2013, gains arising in the hands of shareholders on buy-back of shares is to be taxed as 'capital gains' under section 46A of the Act. The re-characterization undertaken by the income-tax authorities in some cases is not only contrary to the express provisions of the Act, but is also arbitrary and against the stated intent of the law.
- Such actions on the part of the tax authorities result in significant uncertainty and have the potential of leading to prolonged litigation. It is therefore submitted that the Government should urgently clarify that the tax characterization of share buy-backs must be strictly undertaken in accordance with section 46A i.e. as resulting in a capital gains treatment.

2.26 Special Economic Zone ("SEZ") tax incentives should be continued with a clear road map

Issues

- The Hon'ble Finance Minister in his budget speech of 2015 mentions about gradual elimination of various incentives and exemptions.
- In this regard, it may be worthwhile to appreciate that in a developing economy like India, exports play a very vital role for its development and thereby employment generation. SEZ units in this regard should be considered as engines for the growth of exports and development of an economy, as they have a critical for export promotions, generation of foreign exchange, attract investments and provide employment opportunities on a large scale basis to millions of youth. Growth in SEZ is very much

required to put India on global competitive edge, especially if we wish to provide a real fillip to “Make in India” campaign, promote exports and attract investments and thereby providing employment to our millions of youth.

- In today’s competitive world, where we are competing with various fast growth economies where SEZ development is already at very high levels and exports are much needed for development of India, we understand that the statement by Hon’ble Finance Minister for elimination of various tax incentives and exemptions in his budget statement is not meant for SEZ exemptions. However, this statement has created panic in various investor community regarding Indian plans for SEZ exemptions and developments. In such an environment, fresh investment in SEZ areas and its growth may not be possible.

Recommendation

- Hence, we request that clarity should be provided regarding continuation of SEZ exemptions and no plans to withdraw such exemptions in near future to provide stable and predictable tax environment to the investors’ community so that required investments can be attracted for SEZ units.
- The Ministry of Commerce and Industry (Department of Commerce) had recommended the restoration of original exemption from Minimum Alternate Tax (MAT) and Dividend Distribution Tax (DDT) to SEZ developers and units. In line with these intentions of the Government and to attract more investment in the SEZs, the MAT & DDT on SEZ developers and units should be abolished.
- The MAT credit is recommended to be allowed as carried forward and set-off without any time limit.

2.27 Rationalization of provisions of Section 14A and Rule 8D

Issues

As per Section 14A of the Act, no deduction shall be allowed in respect of expenditure incurred in relation to income not includible in the total income.

The determination of the amount of expenditure incurred in relation to the income which is not includible in the total income of the taxpayer is to be done in accordance with the method prescribed, i.e. Rule 8D of the Income-tax Rules, 1962 (the Rules).

Disallowance to be restricted to the extent of exempt income earned.

Recommendation

- The way in which the Rule 8D stands drafted leads to a situation where the quantum of disallowance far exceeds the income, which is not includible in the total income. This could be absurd at times and runs contrary to the intention of Section 14A of the Act.
- It should be clarified that the disallowance as per the deeming provisions of Rule 8D of the Rules should not exceed the amount of exempt income earned and where no exempt income is earned, there should not be any disallowance. This is also in line with decisions of various High Courts.
- Further, it should be explicitly clarified that the interest expenditure which is not directly relatable to exempt income or receipt is to be excluded from the interest expenditure considered for the purpose of computing disallowance under section 14A of the Act read with Rule 8D of the Rules.

2.28 Conversion of Limited Liability Partnership into company - Section 47

Recommendation

- Provisions of Section 115JAA of the Act allowing utilization of MAT credit should be amended to allowed credit for MAT paid by the Company to the successor LLP.
- Turnover criteria should be removed from Section 47(xiiiib) of the Act.

2.29 Abolition of Tax on Listed Securities

Issues

The present tax regime of taxation of listed equity shares and units of equity oriented funds leads to various complexities –

- There is a transaction tax as well as capital gains tax (on short term gains);
- There is a great tax incentive for treaty shopping;
- Taxpayers prefer round tripping of funds due to tax arbitrage between resident and non-residents (using favourable jurisdictions);

Currently, the revenue on account of short-term capital gains taxation on listed securities is small as compared to overall direct taxes collection.

Recommendation

Abolishing the tax on listed securities will provide a big boost to capital markets and, in turn, help attracting investments. It would also be a big step towards ease of doing business in india and in providing certainty to tax payers. Government should abolish tax on gains arising from transfer of listed securities to both residents as well as non-residents.

3. Transfer Pricing (TP)

3.1 Transfer Pricing - Marketing Intangibles

Issues

- Marketing intangibles are crucial sources of value and its value is derived from the company's levels of Advertising, Marketing and Promotion expenditures (AMP) which adds intrinsic value to a company. Revenue authorities are increasingly scrutinizing the cross border transfer, use and further development of intangibles relating to brand and licenses. The ruling of the Delhi High Court in the case of Maruti Suzuki India in 2010, which discusses the creation and compensation for marketing intangibles only underlined this trend. Further, in 2013, the Special Bench of the Delhi Tribunal in the case of LG Electronics India Pvt. Ltd. held that transfer pricing adjustment in relation to AMP expenditure incurred by the taxpayer for creating or improving the marketing intangible for and on behalf of the foreign Associated Enterprise (AE) is permissible. It also held that the said function can be construed as provision of service by the taxpayer to the AE for which, earning a mark-up in respect of AMP expenditure incurred for and on behalf of the AE, is appropriate.
- Recently, the Delhi High Court in the case of Sony Ericsson Mobile Communication India Pvt. Ltd and several other connected matters upheld the tax department's jurisdiction to consider AMP expenditure as an international transaction subject to transfer pricing. The High Court further held that various legal ratios accepted and applied by the Income-tax Appellate Tribunals relying upon the Special Bench ruling in the case of LG Electronics as erroneous and unacceptable. The High Court held that distribution and marketing are intertwined functions and can be analysed together as a bundled transaction and that segregation of non-routine AMP expenditure using the bright line approach is not appropriate. In line with the findings of the Delhi Tribunal in the case of BMW India Private Limited, the High Court also held that separate remuneration for the AMP activities may not be required if such compensation is already provided by way of lower purchase price or reduced payment of royalty. It has been observed by the High Court that, for justifying argument of "margin", selection of comparables, having similar intensity of functions on account of AMP, as the taxpayer, is crucial. Proper adjustments are suggested by the High Court to eliminate the material differences. However, High Court did not provide guidance on the nature of adjustments that may be required.
- In light of the amendment introduced vide Finance Act 2012 which specifically includes marketing intangibles in the expanded definition of international transactions, the Special Bench ruling in the case of LG Electronics India Pvt. Ltd., and the High Court's judgment in case Sony Ericsson and BMW India, identifying a transaction relating to marketing intangible development and substantiating the arm's length compensation for the transfer price of the intangibles would pose great challenges without specific guidance relating to these aspects in the Indian transfer pricing regulations.

Recommendation

- Accordingly, in line with the Organization for Economic Co-operation and Development (OECD) principles and recommendations given by the OECD under Action 8 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Action Plan, guidance should be issued to recognize certain methodologies/ approaches for evaluating the arm's length character of transactions involving marketing intangibles.

3.2 Transfer Pricing of Manufacturing Intangibles

Issues

- Compensation for use of manufacturing intangibles has generally been in the form of royalty pay-outs and is commonly benchmarked by adopting the aggregated approach.

- However, this approach is increasingly challenged by the Revenue Authorities, who insist on adopting transaction-specific approach, and the taxpayer is required to substantiate the economic and commercial benefits derived from the royalty pay-out.

Recommendation

- With the removal of the exchange control limits that was prescribed by the Foreign Exchange Management Act Regulations, it is necessary that guidance be provided to test such transactions particularly in cases of start-up or loss making companies.

3.3 Transfer Pricing of Intra Group Financial Transactions/ Management services

Issues

- Management services are services where an entity in a multinational group renders shared services in the nature of legal, administrative, human resources, information technology, finance, sales/ marketing, etc. to its group affiliates.
- One of the important issues that draws the attention of the Revenue Authorities is the arm's length nature of the compensation paid for such intra-group services to related entities. Another important aspect is demonstrating the benefits derived by the service recipient. The entire onus to substantiate the arm's length payment and benefit received and establishing the 'cost-benefit' analysis by way of maintaining service agreements, basis of charge out rates, allocation keys, evidence of services/ benefits received etc., is upon the taxpayer.

Recommendation

- Accordingly, in the absence of any guidance or industry benchmarks in public domain for testing payments towards intra-group services, detailed guidelines in line with the OECD principles and recommendations given by the OECD under Action 10 of the OECD/G20 BEPS Action Plan., for maintaining specific documentation outlining the various costs incurred in relation thereto and the related benefits derived there from, should be introduced in the regulations. Even the concept of Low value-adding intra-group services as recommended in discussion draft to Intra-group services issued under the above-mentioned Action Plan should be introduced which will result in stream lining the taxpayers and the Revenue authorities' resources towards more high-value transactions.

3.4 Issue of shares – Vodafone controversy

Issues

- Recently, the Revenue Authorities have been alleging that issuance of shares to overseas AEs is subject to transfer pricing provisions. This step of Revenue Authorities has shaken the investors' confidence in India.
- The matter reached the High Court wherein, the contentions of the Revenue Authorities were as under:
 - Shares are issued by the Indian company to its AEs at an undervalued price, by questioning the valuation methodology;
 - Notional interest is to be computed by treating the shortfall resulting from undervaluation of shares as loan advanced by Indian company to its AE.
- However, the Bombay High Court in the case of Vodafone India Services Pvt. Ltd (Writ Petition No 871 of 2014) rejected the contentions of the Revenue Authorities and quashed such transfer pricing adjustment on issuance of shares. The High Court affirmed the contentions of the taxpayer and held that that the undervaluation of shares at the time of issuance does not give rise to any income; the same is on capital account, which can never be brought under the ambit of taxation. Post this High Court decision, the Indian Government decided to accept the verdict of the High Court and not challenge it

in the Supreme Court of India.

Recommendation

- It is recommended that a circular should be issued by CBDT to clarify the law in light of the Bombay High Court decision in the case of Vodafone India Services Pvt. Ltd (Writ Petition No 871 of 2014), directing the Revenue Authorities to respect the legal form of the transaction, not apply transfer pricing provisions and abstain from such re-characterization of under receipt of consideration for issuance of shares as loan. Even the clause 16 of the Annexure to Form No. 3CEB under Rule 10E be revised to exclude the requirement to report the share issue transaction by an Indian Company to its foreign AE.

3.5 Interest on Inter-company loans and Guarantee fees

Issues

- Transfer pricing of cross-border financial transactions deals with inter-company loans, debentures, corporate guarantee charges, cash-pooling arrangements, debtors discounting, etc., and intends to arrive at arm's-length outcome in a related-party scenario. Typically, interest rates on loan transactions between third parties depend on factors like borrowers' credit rating, loan tenor, prevailing market conditions, loan seniority, security to lender(s), etc.
- The Comparable Uncontrolled Price (CUP) method, which is commonly used for arriving at arm's-length interest rates for intra-group loan transactions, demands a high degree of comparability and necessitates complex adjustments. Pricing a guarantee is even more challenging in the absence of comparable data and warrants application of sophisticated transfer pricing techniques. In India, lack of guidelines often leads to application of arbitrary methods for pricing of inter-company financial transactions. The Tribunal has laid emphasis on the credit quality of the borrower while holding that inter-company loans should attract arm's-length interest charge. Further, vide the Finance Act, 2012, the definition of international transactions has been expanded to specifically include capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business which would now give rise to a whole gamut of such financial transactions to be reported by the taxpayer.

Recommendation

- Given the increasing global trend of cross border financing and inter-company lending, it is of paramount importance to introduce appropriate guidance governing the pricing of inter-company funding. Further considering the increased amount of litigation pertaining to the inter-company loans and guarantee transaction, with no clear view of the higher appellate authorities, appropriate clarification on the approach/ methodology to be adopted for analyzing these transactions is required.

3.6 Transfer Pricing Methods - Profit Split Method (PSM)

Issue

- PSM is applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the Arm's Length Price (ALP) of any one transaction. The method involves valuation of non-routine intangible, assigning the combined profit or loss according to each party based on allocation keys and using of projected financials. Lack of clarity on valuation of intangibles and use of complex analysis for splitting the profit or loss has been experienced as the major reasons for the reluctance in using this method in India, both from a taxpayer and revenue perspective.

Recommendation

- Issuance of guidance for application of this method and valuation norms can bring about clarity to the taxpayer on usage of this method especially in light of some recent Tax Tribunal judgments accepting the use of PSM as the most appropriate method.

3.7 Transfer Pricing documentation and scrutiny requirement

Issues

- The documentation requirements are attracted if the aggregate value of the transactions exceeds INR 1 Crore.
- The monetary threshold for mandatory 'transfer pricing' audit is INR 15 Crore.

Recommendations

- These monetary limits have remained static after the introduction of transfer pricing regulations in the Act and seem to be on lower side especially in case of companies, which has associates in various countries. This limit for maintenance of mandatory documentation and initiating scrutiny proceedings requires an upward revision. Also, documentation requirements should enable the Revenue Authorities to arrive at ALP without subjecting the concerned parties to undue cost, time and harassment.
- It is suggested that the threshold for maintaining TP documentation and also for mandatory TP audit should be increased.
- It is further recommended to align the documentation requirements and audit processes to the recommendations made under Action 13 of the OECD/G20 BEPS Action Plan i.e. TP documentation to be maintained under a three-tier structure [Master File, Local File and Country-by-Country (CbC) Report]. OECD has also recommended that all the data provided in the Master File and CbC report should be used only for risk assessment purposes by the Revenue authorities. The OECD has also issued further guidance on implementation of CbC reporting specifying a threshold of € 750 million (approximately INR 5250 crores) and suggested ways for information exchange mechanisms between various governments.

3.8 Adjustments for differences in functions and risks

Issues

- The Indian TP regulations provide for making reasonably accurate adjustments to take into account differences between international transactions and uncontrolled transactions, considering the specific characteristics relating thereto.
- However, in practice there is no guidance or clarity on the manner in which these adjustments are to be made. For example, adjustments in areas such as differences in levels of working capital, differences in risk profile, differences in volumes, pricing on marginal cost, startup losses or capacity utilization and so on, have generally not been permitted by the Revenue Authorities in the course of transfer pricing audits as upheld in certain Tribunal decisions as well.

Recommendation

- Accordingly, suitable guidance on the manner of carrying out economic and risk adjustments to comparable and taxpayer's data is necessary. Further, the Revenue Authorities should be encouraged to duly consider in the course of transfer pricing audits, business strategies and commercial or economic realities such as market entry strategies, market penetration, and non-recovery of initial set-up costs, unfavorable economic conditions and other legitimate business peculiarities while

determining the arm's length pricing

3.9 Valuation under Customs and Transfer Pricing

Both Customs and TP require taxpayer to establish arm's length principle with respect to transactions between related parties. Objective under respective laws is to provide safeguard measures to ensure that taxable values (whether it is import value of goods or reported tax profits) are the correct values on which respective taxes are levied. The above objective, while established on a common platform has diverse end-results as seen below:

- To increase Customs duty amounts, the Customs (General Agreement on Tariffs and Trade Valuation) Cell would prefer to increase the import value of goods
- To increase tax, the Revenue Authorities would prefer to reduce purchase price of goods

Issues

- The diverse end-results create ambiguity in the manner in which the taxpayer should report values under the Customs and the Transfer Pricing. We have judicial precedents which favor and contradict the use of custom valuation in transfer pricing. In the case of Coastal Energy Pvt. Ltd., the Chennai Tribunal endorsed the Transfer Pricing Officer (TPO) decision to apply the customs data for transfer pricing analysis. Similarly, in the case of Liberty Agri Products Pvt. Ltd. the Chennai Tribunal again held that ALP on imports for transfer pricing purposes is to be determined using the rate for customs. Contrastingly, a decision from the Delhi Tribunal in the case of Panasonic Ltd. and the Mumbai Tribunal in the case of Serdia Pharmaceutical highlighted the distinctive objective of Customs valuation and the necessity for separate arm's length analysis as per transfer pricing provisions. Further, in a Chennai Tribunal decision in the case of Mobis India Ltd, the Tribunal held that customs valuation was not acceptable as comparable for ALP determination as the purpose of customs valuation does not fit in the scheme of TP analysis under the Act.
- These contradicting decisions necessitate a greater need for convergence of transfer pricing mechanism under the Act and the Customs Regulations.

Recommendation

- There is a need for a common platform that would provide a 'middle-path' of ALP that is equally acceptable under Customs Law and under the Transfer Pricing.

3.10 Safe Harbour

- On 19th September 2013, the final Safe Harbour Rules (SHRs) were released after considering the comments of various stakeholders.
- Safe Harbour has been introduced for Software development Services (IT services), ITES, Knowledge Process Outsourcing Services (KPO services), Contract Research and Development (Contract R&D) relating to IT services and generic pharmaceuticals, for manufacture and export of core and non-core automobile components and for financial transactions like loan and guarantees.

KPO services and Contract R&D services - Issues and recommendations

- Cost plus margins proposed are too high and above the taxpayer's expectations - The Safe Harbour ratio of 25% in the case of KPO services seems to be in a higher range. A downward reduction in the currently prescribed rates would encourage more taxpayers to opt for the Safe Harbour regime.
- Clarity required in categorization (e.g. for ITES v/s KPO and for IT services v/s Contract R&D relating to IT) – Contrary to industry expectations, the categorization between ITES and KPO services

and IT services and contract R&D relating to software development has not been done away with. To provide distinction from routine business process outsourcing services, the definition of KPO services includes only those services that require “application of knowledge and advanced analytical and technical skills”. The definitions of various eligible international transactions, including that of the ITES and KPO and IT services and contract R&D services relating to software development, as provided in the SHRs leave lot of room for subjective interpretations and consequent controversies/ disputes on categorization of services.

- Moreover, the provisions in the SHRs relating to tax officer’s review of taxpayer’s continued eligibility in subsequent AYs also add to the uncertainty on categorization of services and eligibility for the Safe Harbour.
- It is recommended that additional/ clear criteria are introduced for classification of services. In any case, if such classification is made, it should not be merely based on the nature of services provided and there should be certain other criteria to determine the classification e.g. value of outcome of the activity performed vis-à-vis the ultimate customer etc.

Advancing of intra-group loans – Issues and recommendations

- The credit rating of the borrower is one of the prime considerations for any loan transaction and this has also been duly recognized by the Rangachary Committee (RC) report by recommending different interest rates (for loans above INR 50 crores) for High, Medium, Low and Junk category of borrowers.
- Adoption of 30th June as the date for establishing Base Rate - Considering the dynamic nature of the financial market, the interest rate prevailing as on the date on which loan is granted is of prime importance. Accordingly, interest rate closest to the date of lending, as may be available, should be adopted.
- Benchmarking interest rate year on year - Typically the interest rate should be fixed at the time of entering into the loan arrangement. It should be eligible for Safe Harbour throughout the term of the loan and not just the AYs opted for by the taxpayer for Safe Harbour (valid maximum up to a period of 5 years starting with AY 2013-14 during which SHR are applicable).

Providing intra-group guarantees – Issues and recommendations

- Downward revision of proposed Safe Harbour rate for guarantee commission/ fees: The rate of 2/ 1.75% in the case of guarantees below and above INR 100 crores respectively is on the higher side. In many cases the guarantee fee charged by banks could be much lesser.
- The credit rating of the borrower is one of the prime considerations for any guarantee transaction and this has also been duly recognized by the RC report by recommending different interest rates (for loans above INR 100 crores) for High, Medium, Low and Junk category of borrowers.
- The above SHRs may not necessarily cover Wholly Owned Subsidiaries. It should cover transactions with all AEs.

General issues and recommendations

- Requirement for contemporaneous documentation will continue to apply in its entirety even in case a taxpayer has opted for SHR - Accordingly, the basic objective of simplicity and easy compliance is not being met by the SHR provisions. However, the RC report has recommended that the taxpayers opting for Safe Harbour should be required to maintain only basic documentation like the details of

international transaction, shareholding structure, nature of business and industry and functional analysis. It is therefore recommended that the SHR be amended to provide that the taxpayers opting for Safe Harbour should be exempted from all the documentation requirements and should be required to maintain only basic documentation as recommended by the RC.

- Currently, SHRs have been notified for government owned electricity companies prescribing limited documentation requirements for such companies. It is recommended that more such industries should be covered for simplified documentation
- It is recommended that a clarification should be issued that the Safe Harbour would not become a basis for the Revenue Authorities to challenge the arm' length pricing of the taxpayer in prior years.

3.11 Specified Domestic Transaction

- 'Specified Domestic Transactions' now get covered in the scope of Transfer Pricing provisions if the aggregate amount of all such transactions entered by the taxpayer in the previous year exceeds INR 20 crores (w.e.f FY 2015-16, before that it was INR 5 crores).

Issues

- The term 'specified domestic transaction' has been defined to inter alia mean any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of Section 40A . Such expenditure could possibly include capital expenditure made to such a related person. It should therefore be clarified that these provisions pertain to revenue expenditure only.
- This amendment also covers a scenario wherein the payment of remuneration by the company to its director or relative of such directors is also required to be at arm's length. The same casts an onerous responsibility on the company vis - à- vis justification of the arm's length nature of such payments.
- Currently, there are no provisions relating to corresponding adjustment in transfer pricing regulations in respect to specified domestic transactions. It is important that if any adjustment [upward or downward] is made under the domestic transfer pricing provisions, then corresponding adjustment in the hands of the other party should be invariably made.
- Presently, three different Sections referred to in Section 92BA and Section 92A prescribe varying thresholds for determination of 'related party' which are as under:
 - Substantial Interest – Not less than 20% of voting power – Explanation (b) to Section 40A(2)
 - AE - Not less than 26% of voting power- Section 92A(2)(a) & (b)
 - Associated Person - Not less than 26% of voting power - Section 80A read with Section 35AD(8)

Recommendations

- Necessary guidance for benchmarking directors' remuneration should be provided, as by the nature itself these could be very peculiar transactions depending on the extent of ownership, technical ability, seniority etc.
- This amendment seeks to cover a situation wherein there could not be any loss to the exchequer. The same is not in line with the suggestion provided by the Supreme Court in the case of Glaxo Smithkline. The Supreme Court had provided the situation wherein transfer pricing should be applicable in case of transactions between a profit making and a loss unit/ company. The other scenario which was envisaged by the Supreme Court was transactions between units/ taxpayers

having different tax rates. Other than the scenarios contemplated above, a corresponding adjustment should be allowed and hence provided for in the statute.

- It should be suitably clarified that the transfer pricing provisions would only apply to revenue expenditure referred to in Section 40A(2)(a) , and not to payments made to persons specified in Section 40A(2)(b).
- 'Any other transaction as may be prescribed' covered under Section 92BA may be notified and should be made applicable from prospective effect to avoid undue hardship to the taxpayers.
- Necessary amendments should be made in the domestic transfer pricing provisions to provide for the corresponding adjustments.
- It is suggested that the threshold for determination of 'related party' prescribed in the aforesaid Sections should be harmonized and necessary amendments in this regard should be carried out.
- The words "close connection" appearing in Section 80-IA(10) needs to be clarified to avoid ambiguity in the application of provisions of Section 92BA.
- Further, clarity should be provided with regard to inter-unit allocation of costs between eligible and non-eligible units i.e. whether corporate cost allocations from a non-tax holiday unit of a company to a tax holiday unit of the same company would get covered within the provisions of Section 80-IA(8) and consequently need to be reported as a specified domestic transaction.
- The APA provisions are being made applicable to only international transactions. The same should also be made applicable to domestic transactions covered by transfer pricing regulations.

3.12 Rollback of APA

The CBDT introduced the rollback rules under the APA program on 14 March 2015. There were some ambiguities about the implementation of the rollback rules, and therefore, CBDT issued FAQs clarifying certain issues. In this regard, some of the aspects that need to be further addressed are as under:

Issues and recommendations

Issue - The international transaction proposed to be covered under the rollback is to be the same as covered under the main APA. The term 'same international transaction' implies that the transaction in the rollback year has to be of the same nature and undertaken with the same AEs, as proposed to be undertaken in the future years and in respect of which APA has been reached.

It is recommended that this provision should be relaxed to the extent that the taxpayers with similar transactions with no substantial changes in the functional, asset and risk profile should be allowed to take benefit of this provision. Further, if the same/ similar transaction is undertaken with another AE, the benefit of rollback should be provided.

Thus, it is recommended that the provision should be made applicable to similar nature of transactions and with different AEs.

Issue - The rules provide that if the applicant does not carry out any actions prescribed for any of the rollback years, the entire APA shall be cancelled.

It is recommended that this provision should be relaxed and should not result in the cancellation of the entire APA.

3.13 Applicability of Range concept and use of multiple year data

Issue and Recommendations

The CBDT issued the draft scheme of the proposed rules on 21 May 2015, for computation of the ALP of international transactions or specified domestic transactions undertaken on or after April 1, 2014. Based on the said draft rules, it is proposed as under:

Issue - Range Concept

- Range' concept shall be used only in case the Most Appropriate Method used is Transactional Net Margin Method (TNMM), Resale Price Method (RPM) and Cost Plus Method (CPM)
- 40th percentile to 60th percentile of the data set of series to constitute the range
- A minimum of 9 comparable companies required for applicability of range provisions. Existing Arithmetic Mean would continue if number of comparables are “inadequate” i.e. less than 9

Recommendations – the application of the range concept should also be extended to CUP, PSM and other methods.

Getting a minimum of 9 comparables may be a practical challenge as the number of relevant comparables available in the Indian databases are generally on the lower side. Clarity on the rationale for the threshold of nine comparables would be helpful, since range can also be computed on a much smaller comparable set.

The 40th to 60th range is a very narrow range. It is very unique and is normally not followed globally. It is recommended that an inter quartile range i.e. data points lying between 25th to 75th percentile could be prescribed as it is an internationally accepted norm.

Issue - Use of multiple year data

As per the draft rules, multiple year data should be mandatorily used in case of determination of ALP is by the following three methods:

- TNMM;
- RPM, or
- CPM

It is recommended that multiple year data be allowed to be used across all methods.

The draft Rules allow the data of the current year to be used during the transfer pricing audit by both the taxpayer and the department if it becomes available at the time of audit.

However it is recommended that usage of current year data should not be allowed if was not available at the time of determining the ALP or filing of return, as it would not be contemporaneous in nature and would amount to impossibility of performance.

It is further recommended that multiple year data should be allowed retrospectively for all open AYs where transfer pricing proceedings not yet concluded.

3.14 Amendments in electronic version of Form 3CEB (Transfer Pricing Accountant's Report)

Issues and Recommendations

- The software utility designed for electronic version of Form 3CEB does not provide reporting of transactions in any currency other than Indian rupees. It is suggested to provide reporting of transactions undertaken by banks in foreign currency to provide reporting of transactions in foreign currency.
- Currently, voluminous transactions are required to be manually punched in electronic versions of Form 3CEB available on income tax website. This results in mammoth manual efforts and increases chances of erroneous reporting. Therefore, it is suggested to provide excel utility of Form 3CEB on the income tax website for reporting of certain transaction terms in text form.

3.15 Penalty for failure to keep and maintain information and document etc.

Issue

- The Finance Act, 2012 has substituted Section 271AA with effect from 1 July 2012 which reads as under:-

“271AA. Without prejudice to the provisions of Section 271 or Section 271BA, if any person in respect of an international transaction or specified domestic transaction-

- i. fails to keep and maintain any such information and document as required by sub-Section (1) or sub-Section (2) of Section 92D;
- ii. fails to report such transaction which he is required to do so; or
- iii. maintains or furnishes an incorrect information or document,

the Assessing Officer (AO) or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of each international transaction or specified domestic transaction entered into by such person.”

While the quantum of addition itself is disputable in transfer pricing assessments, fixing the penalty on the assessed income would increase the burden of the taxpayer considerably.

Due to retrospective extension of scope of international transaction, the tax officer or Commissioner (Appeals) can ask the taxpayer to pay penalty under the said Section 271AA @ 2% of value of international transaction due to failure to keep information in addition to another 2% under Section 271G for not furnishing the information besides regular penalty under Section 271(1)(c) . This would result in multiple tax demand on arbitrary values.

Recommendation

- It is, therefore, suggested that penalty should be restricted to tax in dispute and not linked to the value of transaction.

Issue

- While the Finance Act, 2014, extended the power to levy penalty under Section 271G to the TPO for failure to furnish information/ TP documentation, which was earlier restricted to tax officer or the Commissioner (Appeals), interestingly, there has been no amendment to Section 271AA (which prescribes the power to levy penalty for failure to keep and maintain information and document, etc. in

respect of certain transactions), currently provided only to the tax officer or the Commissioner (Appeals), possibly seeking to limit powers to levy penalty for matters relating to non-compliance with statutory provisions, only to tax officers/ Commissioner (Appeals), while extending powers to levy penalty to TPOs for matters relating to proceedings in the course of conduct of TP audits.

Recommendation

- Considering that clause (iii) to Section 271AA also states that penalty shall be levied for maintaining or “furnishing” incorrect information or document, as the Act of “furnishing” is typically associated with a TP audit proceedings, it is recommended that there should be some consistency on this front.

4. Personal Taxation

4.1 Taxation of specified security or sweat equity shares allotted to employees under Employee Stock Option Plans (ESOPs) in case of migrating employees

Section 17(2) (vi)

Issues

- Taxation of ESOPs creates an issue in the case of migrating employees, who move from one country to another, while performing services for the company during the period between the grant date and the allotment date of the ESOP. The domestic tax law is unsettled on the taxation of such migrating employees and does not clearly provide for such cases.

Recommendation

- During the erstwhile Fringe Benefits Tax (FBT) regime, there was a specific clarification on the taxability, where the employee was based in India only for a part of the period between grant and vesting. However, there is no specific provision in this regard under the amended ESOP taxation regime from 1 April 2009.
- The Government may look at providing clarity on the taxability of ESOP’s for such mobile employees

4.2 Partial double taxation of contribution to superannuation fund in excess of INR 1 lakh

Section 17(2) (vii)

Issues

- Section 17(2)(vii) inserted by the Finance (No.2) Act, 2009, provides that any contribution to an approved superannuation fund by the employer, to the extent it exceeds one lakh rupees, will be taxable as a perquisite in the hands of the employee.
- It has to be appreciated that contributions to superannuation fund may or may not result in superannuation benefits to the employees, since there are various conditions to be fulfilled by the employees like serving a stipulated number of years, reaching a certain age etc. Further, the pension payments are subject to tax at the time of actual receipt by the employee after his retirement. This may lead to partial double taxation for the employee where the contributions had been taxed earlier also (when the contributions exceeded INR one lakh).

Recommendation

- It is recommended that the employer contributions to an approved superannuation fund should be made fully exempt from tax.

4.3 Non-transferable paid vouchers usable only at eatable joints

Section 17(2)(viii)

Issues

- As per proviso to Rule 3(7)(iii), if food and non-alcoholic beverages are provided by the employer to an employee during working hours at office or business premises or through non-transferable paid vouchers usable only at eatable joints, the value of such facility/ benefit to the extent of INR 50 per meal or to tea or snacks, is exempt from tax.
- In the current scenario, many employers provide the aforesaid benefit to employees through electronic meal swipe cards. The current rules [Rule 3(7)(iii)] expressly provide the exemption from tax for paid vouchers only and not the electronic cards. Accordingly, their tax treatment/ exemption is not free from doubt. Such electronic meal cards were covered under erstwhile FBT regime.

Recommendation

- Further, the electronic meal cards should expressly be covered for the aforesaid exemption/ benefit.
- The aforesaid limit of INR 50 per meal/ tea/ snack is inadequate, keeping in view the increased cost of food etc., hence needs to be revised.

4.4 Provision for the employer to provide DTAA benefits while calculating TDS

Section 192

Issues

- Under the current tax regime, there is no provision under the Income-tax Act, 1961 which enables an employer to consider admissible benefits under the respective DTAA (e.g. credits for taxes paid in another country/ treaty exclusions of income), while computing tax to be deducted under Section 192 at the time of payment of salaries to employees.
- Due to the above, it creates cash out-flow issues to the employees (migrating employees coming to and leaving India) who are initially subject to full TDS by their employers and thereafter required to claim refunds on account of DTAA benefits while filing their income tax return. Many of these employees may complete their assignments and leave India prior to obtaining their tax refunds which also creates hardships with respect to receiving back the refund amounts.

Recommendation

- It is recommended to provide for claiming relief available under the DTAA, at the time of TDS.

4.5 Double taxation in case of buy back of shares by the company in case of ESOP's

Issues

- At the time of buy back of shares (not being shares of listed on a recognised stock exchange), by a company from the shareholder, the company is liable to pay income tax on distributed income under section 115QA. "Distributed income" has been defined as the consideration paid by the company on buy-back of shares as reduced by the amount which was received by the company for issue of such shares. Under ESOP's, the employee has already paid tax on the perquisite value at the time of exercise of shares (i.e. tax on FMV) as on date of exercise less the issue price or amount actually paid by the employee). Hence there is a double taxation on the difference between the FMV on the date of exercise and the issue price of the shares.
- Section 49(2AA) specifies that where the capital gain arises from the transfer of specified security or sweat equity shares referred to in sub-clause (vi) of clause (2) of section 17, the cost of acquisition of such security or shares shall be the fair market value which has been taken into account for the

purposes of the said sub-clause. Similar provision is missing in section 115QA.

Recommendation

- It is recommended that issue price should be changed to FMV as on the date of exercise for the shares allotted under ESOP. Accordingly, the tax should be calculated on the difference between the buy-back price and FMV on the date of exercise.