MPC & CO LLP
CHARTERED ACCOUNTANTS

Corporate Update

July - August | 2020

CONTENTS

INTERNATIONAL TAX

- Project Office not a fixed place PE where no core business activity was carried out by it 3 - 4
- Guidelines on Mutual Agreement Procedure 5 - 8

DOMESTIC TAXATION

- Tax Administration - A paradigm shift 8 - 10
- Non-Compete Fee was an Exempt Capital Receipt Prior to Assessment Year 2003-04 10 - 12

TRANSFER PRICING

- Working Capital adjustment denied as outstanding receivable from AE exceeds shareholders' funds 12 - 13

REGULATORY

- Draft Defence Production and Export Promotion Policy, 2020 13 - 17

GOODS AND SERVICES TAX

- Taxability of Marketing and Consulting Services 17
- Taxability of Salary cost of Expat Employees by Project Office 17 - 18
- General Updates 19

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FOREWORD

Dear Reader,

The Prime Minister of India, Mr. Narendra Modi, has recently unveiled 'The Taxpayer's Charter', intended to make compliance easier for taxpayers & to build trust in the tax administration. The Charter outlines the commitment of tax administration to treat taxpayers as honest, respect their privacy, maintain confidentiality, reduce tax compliance cost etc.

Adoption of faceless tax assessment and appeal is a major thrust of the Charter to reduce interface between the taxpayers & tax administration and thus, reduce harassment of taxpayers.

It is indeed a major and bold step and we all hope it is implemented in letter and spirit by the tax administration, as envisioned by the Prime Minister.

The Ministry of Finance, Government of India, also issued a detailed "Mutual Agreement Procedure Guidance" ('MAP') based on the Action 14 Final Report on "Making Dispute Resolution More Effective", under the BEPS project.

The focus of the Prime Minister on making India self-reliant, a global manufacturing hub producing in India for the world, also saw certain policy announcements by the Government in this direction. Particularly, in the defence sector, where India is one of the biggest importers of the world, the Government made a draft policy announcement to curb imports of certain defence items, to promote 'Make in India' policy. A note on the policy forms part of this edition of Corporate Update.

C.S. Mathur
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International Tax

Project Office not a fixed place PE where no core business activity was carried out by it

DIT vs. Samsung Heavy Industries Co. Ltd. (TS-352-SC-2020)

Recently, the Hon'ble Supreme Court of India dealt with the issue of existence of fixed place permanent establishment (PE) under Article 5(1) of the Double Taxation Avoidance Agreement between India and the Republic of Korea ('DTAA'). The Apex Court held that the project office ('PO') of the Korean company did not constitute a fixed place PE in India as no core business activities were carried on by the PO.

On facts, Samsung Heavy Industries Co. Ltd. (the taxpayer) is a company incorporated in South Korea. Oil and Natural Gas Corporation (ONGC) awarded a turnkey contract to a consortium comprising of the taxpayer and an Indian company in February, 2006 for carrying out the work of surveys, design, engineering, procurement, fabrication, installation and modification at existing facilities, and start-up and commissioning of entire facilities covered under the Project.

The taxpayer had set up a PO in India to act as "a communication channel" between the taxpayer and ONGC in respect of the Project. The Reserve Bank of India (RBI) approval did not place any restrictions on the activities of the PO.

Pre-engineering, survey, engineering, procurement and fabrication activities took place abroad. The PO had only two employees who were not involved in any technical activities. Furthermore, the PO did not incur any expenditure in relation to execution of the contract activities.

The taxpayer filed a Nil tax return for tax year 2006-07 as it had incurred loss in relation to the activities carried out by it in India.

However, the Assessing Officer adopted a view that the Project was an indivisible "turnkey" project whereby ONGC was to take over the project that was completed only in India and the work relating to fabrication and procurement of material was a part of the contract. The Assessing Officer held that the work was wholly executed by the PE in India, which was associated with the designing or fabrication of materials. As such, the Assessing Officer issued the draft assessment order proposing to attribute 25% of revenue allegedly earned outside India as income attributable to the PE in India. On objections filed by the taxpayer, the Dispute Resolution Panel upheld the action of the Assessing Officer stating that opening of a project office indicated that the taxpayer was doing something more than what would have been done through a liaison office and that the agreement was a ''turnkey" project which could not be split up, as a result of which entire profit from the Project was earned in India.

On appeal, the Tax Tribunal relied on the resolution of Board of Directors of the taxpayer company which stated that the PO was opened for coordination and 'execution' of impugned project. The Tax Tribunal also observed that there were no restrictions on the PO in the permission given by the RBI and no material was brought on record by the taxpayer to prove that activities of its PE were preparatory or auxiliary in nature. As such, the Tax Tribunal confirmed the order of the Assessing Officer and held that the contract was indivisible.

On further appeal, the High Court concerned itself only with the percentage of attribution of income to the PO and observed that there was no justification for attribution of 25% of the gross revenue of the taxpayer outside India to the business carried out by the PO in India. The assessment order and the order of Tax Tribunal were, thus, set aside by the High Court. Aggrieved by the order of the High

Court, the Revenue preferred an appeal before the Supreme Court of India.

Before the Supreme Court, the taxpayer contended that the PO in India did not carry out any core business activity of the taxpayer. The PO consisted of only two employees, neither of whom had any technical qualification. Further, the accounts as produced showed that the PO had not incurred any expenditure on the execution of the Project. The burden of proving that the taxpayer had PE in India was on the tax authorities and it had failed to establish the same. The taxpayer further contended that even if there was a PE in India through which the core business activity of the taxpayer was carried out, no taxable income could be attributed to it as the project resulted in loss as per audited accounts of the taxpayer.

The Revenue distinguished the decision of Hyundai Heavy Industries Co. Ltd. [(2007) 7 SCC 422] on the facts that in that case the turnkey project was bifurcated into two parts, one agreement for offshore design, manufacture, erection and another agreement for onshore installation and the installation PE was set up only long after the revenue had been earned from manufacture, design etc.

The Supreme Court placed reliance on its various decisions on PE including Hyundai Heavy Industries Co. Ltd. (supra), Ishikawajma-Harima Heavy Industries Ltd. (2007) 3 SCC 481, Morgan Stanley & Co. Inc. (2007) 7 SCC 1 and E Funds IT Solution Inc. (2018) 13 SCC 294 and re-emphasized that the condition precedent for applicability of Article 5(1) of the DTAA and the ascertainment of a PE is that it should be an establishment “through which the business of an enterprise” is wholly or partly carried on. Further, the profits of the foreign enterprise are taxable only where the said enterprise carries on its core business through a PE. Maintenance of a fixed place of business which is of a preparatory or auxiliary character in the trade or business of the enterprise would not be considered to be a PE under Article 5. Also, it is only so much of the profits of the enterprise that may be taxed in the other State as is attributable to that PE. It was also reiterated that the burden of proving that a foreign taxpayer has a PE in India and must suffer tax in India is on the Revenue.

The Supreme Court observed that the Board Resolution indicated that the PO was established to coordinate and execute delivery documents in connection with the construction of offshore platform and modification of existing facilities for ONGC, rather than for the coordination and execution of the entire Project itself (as erroneously held by the Tax Tribunal). The accounts of the PO evidenced that no expenditure relating to the execution of the contract was incurred by the taxpayer. Only two persons were working in the PO, neither of whom was qualified to perform any core business activity. It, as such, held that findings on facts as held by the Tribunal were perverse.

Accordingly, the Supreme Court held that the PO could not be said to be a fixed place of business from where core business activities were carried out and it was merely an auxiliary office for liaising between the taxpayer and ONGC. As such, no profits from offshore revenue could be attributed to India for taxation.

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Guidance on Mutual Agreement Procedure

Mutual Agreement Procedure ("MAP") provides additional dispute resolution mechanism under Article 25 of the OECD Model Tax Convention, independent of the remedies provided under domestic tax law. Almost all the DTAAs entered into by India have the MAP Article, mainly based on OECD Model Tax Convention. Article 25 provides that MAP can be invoked by a resident person where he considers that action of the other contracting state results or will result in taxation not in accordance with the DTAA.

MAP is of fundamental importance to the proper application and interpretation of DTAA to ensure that taxpayers entitled to the benefits of the DTAA are not subject to taxation by either of the Contracting States which is not in accordance with the terms of the DTAA. Action 14 of the BEPS Action plan: "Making dispute resolution mechanism more effective", is aimed to strengthen the effectiveness and efficiency of the MAP process, in order to ensure that the measures developed to address BEPS issues should not lead to unnecessary uncertainty for compliant taxpayer and to unintended double taxation.

BEPS Action 14 report, as a minimum standard, provided, inter alia, that countries should publish rules, guidelines and procedures to access and use the MAP and take appropriate measures to make such information available to taxpayers. Countries should ensure that their MAP guidance is clear and easily accessible to the public and that they should commit to a timely resolution of MAP cases within an average timeframe of 24 months.

In line with these aforesaid objectives, the Central Board of Direct Taxes ("CBDT") on August 07, 2020 has issued detailed guidance to implement MAP procedure. The erstwhile rules dealing with MAP provided guidance and processes in this regard. However, the guidance was not available in a comprehensive and consolidated manner. Recognizing the need for the same to achieve the desired objectives, the Government had substituted Rule 44G on 6th May, 2020 vide Notification 23 to provide a detailed rule on the aforesaid.

MAP procedure under new Rule 44G

The procedure under the new rule is as under:

1) Where a resident in India is aggrieved by any action of the tax authorities of any country outside India, which is not in accordance with the DTAA, he may make an application in Form No. 34F to the Competent Authority ("CA") in India seeking to invoke MAP, if provided in the DTAA.

2) Where reference is received from the CA of the other country with respect to any action of Indian tax authority or tax authority of the other country, the CA in India shall convey his acceptance for taking up the reference under MAP to the CA of the other country.

3) With respect to the issues contained in Form No. 34F filed by the Indian resident under MAP or under the reference received from the CA of the other country, the CA may call for the relevant records and additional documents from the assessee or the Indian tax authorities or have a discussion with them to understand the actions of the tax authorities in India or outside India.

4) CA in India shall endeavour to resolve the issues under MAP within an average time period of twenty-four (24) months.

5) The resolution reached under MAP cannot result in income to fall below as declared in the return of income, except where effect is to be given in case of MAP involving adjustment made by other

country's tax authority in the case of Indian taxpayer.

6) The assessee shall communicate his acceptance or non-acceptance of the resolution in writing to the CA in India within thirty days of receipt of the communication from the CA.

7) The assessee's acceptance shall be accompanied by proof of withdrawal of appeal pending on the relevant issue.

8) The CA shall communicate the resolution as reached under MAP (after receipt of acceptance from the assessee) to the jurisdictional Chief Commissioner, who shall forward it to the Assessing Officer ("AO").

9) The AO shall give effect to the resolution arrived at, by a written order, within one month from the end of the month in which the communication was received by him and intimate the assessee the tax payable by the assessee, if any. A copy of the order shall be sent to the CA in India.

10) The assessee shall pay tax within the time as specified by the AO and submit the proof thereof. Thereafter, the AO shall withdraw pending appeal, if any, filed by the department.

The MAP guidelines issued by CBDT with regard to the procedure as outlined in new Rule 44G stipulate the situations under which the access to MAP shall not be available, besides laying down detailed procedure for resolution under MAP.

Major highlights of the guidelines

1. In most of the tax treaties of India, the time limit for making application for MAP is three years from the first notification of the action giving rise to such taxation. However, in some DTAAs, the time limit is either more or less than three years. Where it is so, India would ensure that the same are changed to three years through amendment of such tax treaty through MLI or through bilateral negotiations.

2. Where application for MAP is submitted by an associated enterprise or related party of an Indian taxpayer before the CA of its country of residence, in respect of any order/action of the tax authorities of India, a copy of such MAP application must be provided to the CA of India.

3. The CA of India shall endeavour to resolve MAP cases within an average time period of 24 months, though it may not be possible for CAs of both countries to agree on a resolution in all cases.

4. If both the CAs successfully resolve a MAP case, they would formalize a mutual agreement amongst themselves as early as possible. The CA of India shall intimate the Indian taxpayer who had applied for MAP about the terms and conditions of the resolution. The MAP case will thus be closed by both the CAs as resolved. If both the CAs are unable to resolve a MAP case, they would close the MAP case as unresolved and CA of India shall inform the Indian taxpayer about the non-resolution of the dispute.

5. It has also been provided that India shall provide access to MAP even in a situation where the Indian tax authorities apply domestic anti-abuse provisions.

6. Further, in a situation where obligation to deduct tax at source on the payment made by an Indian entity to a non–resident is enforced by an order u/s 201 of the Income tax Act and the same is disputed by the non-resident entity, MAP access shall be provided to such non-resident. However, such action being purely under the domestic law and not determining any tax on income, the MAP discussion will be taken only after the

assessment order (which results in taxation not in accordance with the DTAA) is passed in the case of the non-resident taxpayer.

7. It has also been clarified that the CA of India would be obligated to make secondary adjustment part of the MAP resolution in respect of cases involving Primary Transfer Pricing adjustment pertaining to FY 2016-17 and thereafter.

8. The collection of the tax demand relating to the issues considered under MAP shall be kept in abeyance, in accordance with the terms and conditions of the MOU signed with few countries under the ambit of MAP Article. Where no such MOU has been entered into, the suspension of collection of tax demand shall be governed by domestic law of India (including instructions/ clarifications issued by CBDT).

Excluded cases

There are a few circumstances where CA of India would not negotiate any other outcome than what has already been achieved in such circumstances. Such circumstances are as under:

a) Advance Pricing Agreement (APA)

b) If Safe Harbour as per prescribed rules has been opted for by the taxpayer

c) Where an order of the Tax Tribunal has been passed, except where the Tax Tribunal only sets-aside the issue for fresh adjudication. In such a case, access of MAP would be provided again after the fresh adjudication by the tax authorities, if requested for by the taxpayer

d) Where the issues are covered by order of Income Tax Settlement Commission

e) Where Advance Ruling was sought and has been pronounced on the relevant issue

Consequential impact of MAP resolution

As regards consequential issues of levy of interest and penalty which are linked to quantum of income, pertaining to issues resolved under MAP, such interest and penalty shall be varied in the same proportion as the variation in the quantum of income due to MAP resolution.

However, in case of fees or penalty which is not connected to the quantum of income, the same would not be affected by the resolution under MAP.

Implementation of MAP resolution

There are no legal or administrative impediments to implementing MAP outcomes and MAP resolution shall be implemented in each and every case. However, the MAP outcome in a case where for the same assessment year the Tax Tribunal has pronounced its order, the MAP resolution shall not be implemented. The CA of India would inform his counterpart about the outcome of the Tax Tribunal order and request them to provide correlative relief for the adjustment sustained by Tax Tribunal, if any.

The detailed guidance issued by the CBDT with regard to MAP procedure will be helpful in resolving the issue in a timely and efficient manner. The introduction of recommendatory time period for the conclusion of the resolution of the case under MAP is a welcome step and would help in reducing the time involved in resolution of such cases.

The aforesaid guidelines are applicable to all MAP cases pending with the CA of India as on May 06, 2020.

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Domestic Taxation

Tax Administration - A paradigm shift

Background

The Central Government had envisioned major procedural reforms in income tax administration, with a view to bring fairness and transparency in tax procedures. The paradigm shift from a tax adversarial approach to a tax friendly approach is based on three pillars, namely, seamless, painless and faceless tax administration.

At the same time, the Government has tirelessly worked to enhance the tax base of the country, by promoting full compliance with tax laws.

To meet both ends, the Government has undertaken a major revamp of tax administration procedures, with an increased utilization of technology driven systems such as artificial intelligence, data analytics etc.

On August 13, 2020, the Prime Minister of India launched the 'Transparent Taxation - Honouring the Honest' platform. With this platform, the Government expects to conduct faceless assessments and faceless appeals, while also articulating the much-awaited taxpayer's charter.

Taxpayer's Charter

While the legislative framework of the taxpayer's charter was laid by the Finance Act, 2020, the charter has been issued now on August 13, 2020. The taxpayer's charter encapsulates the tax authority's commitment to taxpayers, as well as its expectations from taxpayers. A formal notification enshrining the taxpayer's charter into the statute is expected soon.

The fourteen-point commitment of the tax department as per the taxpayer's charter has been summarized hereunder:

- Provide fair, courteous, and reasonable treatment
- Treat taxpayer as honest
- Provide mechanism for appeal and review
- Provide complete and accurate information
- Provide timely decisions
- Collect the correct amount of tax
- Respect privacy of taxpayer
- Maintain confidentiality
- Hold its authorities accountable
- Enable representative of choice
- Provide mechanism to lodge complaint
- Provide a fair & just system
- Publish service standards and report periodically
- Reduce cost of compliance

Furthermore, the expectations of the tax department under the charter are as under:

- Be honest and compliant
- Be informed
- Keep accurate records
- Know what the representative does on its behalf
- Respond in time
- Pay in time

One may say that the taxpayer's charter does resonate the overall vision of the Government to achieve transparency, accountability, fairness, ensuring privacy and increased compliance. However, the success of this charter shall largely depend on the resolve of the Government to stand by its commitments.

Faceless Assessment and Appeals

Under the 'Transparent Taxation - Honouring the Honest' platform, the Government has also kickstarted the Faceless Assessment and Faceless Appeal scheme. Under this scheme, tax assessments, penalties and appeals [before the first appellate authority, i.e. Commissioner (Appeals)], shall be conducted electronically without any personal interface with the officers of the tax department.

While the facility of electronic assessment (i.e. assessment through digital modes of communication) was already in vogue, the faceless assessment scheme was only introduced in October 2019 on a pilot basis in eight Indian cities. Under this scheme, the Indian tax administration had already issued approximately 58,000 notices, proceedings of which, are expected to be concluded by September 2020.

The faceless assessment scheme (with certain procedural amendments) has now been extended vide Notifications No. 60/2020 and 61/2020 dated August 13, 2020, to **all** assessments with effect from August 13, 2020, subject to certain exceptions, namely, international tax cases and search cases. The CBDT has also clarified that any assessment order which does not conform to the same shall be treated as invalid. Furthermore, the faceless appeal scheme shall commence from September 25, 2020.

This scheme shall offer savings to taxpayers, both in terms of cost and time, by dispensing off the requirement of personal visit to the tax office. However, the key game changer under the new scheme is that the assessments/ appeals shall be conducted in a faceless manner. In other words, the identity of the tax officials conducting the assessment or appeal shall be unknown to the taxpayers. The Government expects that such move shall promote fair play, objectivity and minimize the arbitrariness which hitherto was prevalent in dealings with tax authorities.

Another key feature of this scheme is team-based assessments with dynamic jurisdiction. The centralized authority which has been entrusted with the task of passing assessment orders, issuing notices and acting as a single point interface with the taxpayer is the **National E-Assessment Centre ('NeAC').** Furthermore, **Regional E-assessment units (ReAC)** shall be set up for providing a supervisory role in assessments. The actual assessment related work, such as identification of issues, analysis of material etc., shall be performed by **Assessment Units ('AU').** The aforesaid assessment units shall be supported by the following three units:

- **Verification units** for functions such as cross verification, enquiry, examination of books etc.;
- **Technical units** to provide technical assistance on matters such as legal, accounting, transfer pricing etc.;
- **Review units** which shall perform review of assessment orders framed by AUs.

With the dynamic jurisdiction feature, the existing territorial system of jurisdiction shall be done away with, in respect of the cases that fall within this scheme. Henceforth, scrutiny cases shall be allocated to any AU as well as other supporting units based on an 'automated allocated system'. As such, various units performing an assessment may be spread out at different geographical locations across the Country. Such dynamic jurisdiction shall ensure optimum utilization of resources available to the tax administration and shall also facilitate functional specialization.

The Government is in the process of carrying out significant restructuring of resources across various cadres in the tax department. Moreover, two-thirds of its manpower shall be utilized for conducting faceless assessments, while the remaining manpower shall perform

residuary functions, shall as investigations, order rectifications, demand recovery, appeal effect etc.

It may be mentioned that technology shall play a vital role in the entire faceless procedure. The entire process starting from selection of cases, issuance of notice, filing of submissions, authentication of documents and passing of orders etc. shall be conducted electronically. The tax department shall employ technologically advanced systems of artificial intelligence and data analytics in various facets of the faceless scheme, such as, identification of cases to be selected for scrutiny. With this move, discretion and bias in selection of cases shall be eliminated to a great extent.

For this purpose, a digital platform shall be developed by the tax authorities with mobile application support. Moreover, in case where any adverse assessment is being proposed, the taxpayer can seek an opportunity of personal hearing (subject to approval of prescribed authorities) which shall be exclusively conducted through video conferencing or similar technology.

The NeAC is already in the process of preparing Standard Operating Procedures on various procedural aspects, to facilitate smooth functioning of the faceless scheme.

The new scheme shall go a long way in reducing red tapism, bureaucracy and high handedness of tax authorities, while resulting in savings of cost and time for the taxpayers. That being said, taxpayers should exercise caution while undergoing assessment, inasmuch as the lack of personal interaction with tax authorities could also be counter-productive. It would therefore be essential that notices/ questionnaires of the tax department are answered in entirety and comprehensively, as any question left unanswered or inadequately answered may be adversely construed by tax authorities.
It would also be necessary to comply with tax notices in a timely manner, so as to avoid any adverse implications. It therefore follows that taxpayers should maintain robust documentation well in advance to facilitate timely compliance with notices of the tax department. This aspect assumes greater significance, considering that the time period for conclusion of assessment proceedings has been reduced in a phased manner. It is also noteworthy that under the amended faceless scheme, provision has now been made for seeking adjournment or extension of time for filing of response by taxpayers.

The taxpayer's charter and faceless assessment/ appeal scheme is an ambitious step by the Government and may instill the much-needed confidence in the minds of the taxpayers. However, it would be necessary for the Government to abide by the taxpayer charter in letter and spirit, while conducting assessments and appeals under the faceless scheme.

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Non-Compete Fee was an Exempt Capital Receipt Prior to Assessment Year 2003-04

Shiv Raj Gupta v. CIT. (2020) 117 taxmann.com 871 (SC)

The Hon'ble Supreme Court held that Non-Compete Fees received by the Appellant was an exempt capital receipt and was not taxable under Section 28(ii)(a) of the Income-tax Act for the purpose of computing income under the head 'Profits and Gains of Business and Profession' (PGBP/ Business Income).
As per provisions of Section 28(ii)(a) of the Income-tax Act, any compensation or other payment due to or received by any person in connection with the termination of his

management or the modification of the terms and conditions relating to his management was chargeable to tax as income under the head PGBP in the hands of the said person.

This case relates to Assessment Year 1995-96, when the Appellant along with his family sold controlling stake in M/s Central Distillery and Breweries Ltd. (CDBL) to M/s Shaw Wallace Company Group (SWC Group) by way of a Memorandum of Understanding (MoU). The Appellant vide a Deed of Covenant gave an undertaking of not engaging in manufacturing, dealing and supplying or marketing of liquor for a term of 10 years in exchange for a sum of INR 66 million. Further, a sum of INR 30 million out of INR 66 million was to be kept deposited with SWC Group for a period of 2 years under a public deposit scheme for ensuring that there was no breach of the signed MoU.

On conclusion of the assessment proceedings, the Assessing Officer sought to tax the sum of INR 66 million under the provisions of Section 28(ii)(a) of the Income-tax Act holding the entire arrangement of Deed of Covenant to be colourable device/ sham transaction. The Commissioner (Appeals) dismissed the appeal of the Appellant in favour of the Revenue. On appeal before the Tax Tribunal, the matter was referred to a third member of the Tribunal and the appeal was allowed by a majority in favour of the Appellant. On further appeal before the High Court of Delhi, it was held that the amount of INR 66 million was not taxable as income under the head PGBP, but rather was to be taxed as 'Capital Gains' in the hands of the Appellant.

While examining the aforesaid issue, the Hon'ble Supreme Court firstly, disregarded the finding of the High Court, wherein, it was held that the figure of INR 66 million received by the Appellant as non-compete fee does not appear to be a realistic payment when the Appellant had in fact transferred shares and lost control and management of CDBL. The Hon'ble Apex Court placing reliance on its own plethora of decisions held that the commercial expediency has to be judged from the point of view of the Appellant and the Revenue had no business to guess the rationale behind commercial or business expediency.

Furthermore, holding the majority judgment of Tax Tribunal to be correct, the Hon'ble Supreme Court reiterated the stand of the Tax Tribunal that the non-compete fee of INR 66 million was paid solely to the Appellant based on negotiations between SWC Group and the Appellant, as the Appellant had acquired considerable knowledge, skill, expertise and specialization in the liquor business. The Hon'ble Supreme Court further reiterated that deposit of INR 30 million out of INR 66 million with SWC Group was akin to a penalty clause which highlighted the fact that there was no colourable device involved in having two separate agreements for two entirely separate and distinct purposes.

Thereafter, the Hon'ble Supreme Court placing reliance on its own decisions in the case of *Guffic Chem (P.) Ltd. v. CIT [2011] 4 SCC 254* and *Gillanders case [(1964) 53 ITR 283]* held that the compensation received by the assessee for loss of agency was a revenue receipt whereas the compensation attributable to a negative/ restrictive covenant was a capital receipt.

The Hon'ble Supreme Court further highlighted the fact that non-competition fees had always been held to be capital receipt and that the legislature had vide Finance Act, 2002 sought to tax capital receipt by introducing Section 28(v-a) provision in the Income-tax Act.

In light of the above, the Hon'ble Supreme Court held that Non-Competition Fees received prior to Assessment Year 2003-04 was an exempt capital receipt which was not taxable under provisions of Section 28(ii) of the Act. Further, a corollary may be drawn that post Assessment Year 2003-04, Non-Competition Fees received by a person shall

be regarded as a revenue receipt taxable under the provisions of Section 28(va) of the Income-tax Act.

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Transfer Pricing

Working Capital adjustment denied as outstanding receivable from AE exceeds shareholders' funds

Techbooks International Pvt. Ltd TS-353-ITAT-2020(DEL)-TP

In a recent judgement the Tax Tribunal, Delhi Bench upheld the order of Dispute Resolution Panel ('DRP') treating outstanding receivable as separate international transaction. Further, it denied working capital adjustment to the arm's length price of main business transaction, which takes into account the impact of related outstanding receivable, holding that the outstanding receivable from the AE exceeding shareholders' fund is equivalent to shareholders' funds and is not the main business transaction.

On the facts of the case, the assessee is a wholly-owned subsidiary of Aptara Inc. USA and is primarily engaged in the provision of IT enabled data conversion service to its AE. For the relevant year, the case of the assessee was referred to the transfer pricing officer ('TPO'), who made adjustment to the transfer price of international transaction of provision of IT enabled services and also held related outstanding receivable from AE as unsecured loan, making adjustment on account of interest.

The assessee filed objection before the DRP against the aforesaid adjustments. In relation to the transaction of provision of IT enabled services, based on the exclusion and inclusion of comparable, as directed by the DRP, the adjustment made to the transfer price was deleted. Regarding the outstanding receivables from the AE, the DRP upheld the TPO's order that since there was inordinate delay in receipt of outstanding amount, interest on such amount was chargeable from the AE. Also, the DRP noted that the assessee was exposed to exchange risk on receipt of belated payment. However, relying on the order of Tax Tribunal in the assessee's own case in earlier years, the DRP held that interest will be chargeable for receivable outstanding beyond 150 days period as against 60 days as held by TPO. It further directed interest to be calculated at LIBOR +300 points in view of decision of Hon'ble Delhi High Court in case of CIT v. Cotton Naturals (I) (P.) Ltd. [2015] 55 taxmann.com 523/231 Taxman 401 (Delhi).

Aggrieved, the assessee filed an appeal before the Tax Tribunal. Subsequently, the assessee also raised an additional ground regarding working capital adjustment which was admitted by the Tax Tribunal.

Before the Tax Tribunal, the assessee contended that the transaction of interest on receivable relates to the main business transaction, i.e. provision of services and hence, it cannot be characterized as a separate independent transaction. Further, it contended that the working capital adjustment to the transfer price of services provided takes into account the impact of outstanding receivable and based on the benchmarking of such adjusted transfer price the transaction was at arm's length. Therefore, no separate addition can be made for interest on outstanding receivable. To support such argument the assessee relied on the decision of the coordinate bench in case of Kusum Healthcare Private Limited versus ACIT (ITA number 6814/del/2014], which has been upheld by the Hon'ble High

Court of Delhi. The assessee further submitted that its AE was facing genuine cash crunch which led to inordinate delays.

The Tribunal, citing the co-ordinate bench decision in the earlier years' case of the assessee, upheld the order of DRP that the receivable outstanding beyond 150 days will be treated as separate transaction.

With regard to the working capital adjustment, the Tribunal on examination of annual accounts of the assessee observed that current year outstanding receivable from the AE was more than the shareholders' funds available with the assessee. As such, it held that the total shareholders' funds are available with its AE as an interest free trade receivable which shows that outstanding receivable from the AE is not the main business transaction of provision of services. Further, stating that the assessee has failed to show the difference in working capital of the assessee vis-à-vis the comparable companies, the ground of working capital adjustment was dismissed. Accordingly, the adjustment of interest on outstanding receivable by DRP/ TPO was confirmed.

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Regulatory

Draft Defence Production and Export Promotion Policy, 2020

India has been among the biggest arms importers in the world. The defence budget of India is steadily rising over the last several years with the present budgeted estimate for FY 2020-21 reaching INR 113,734 crore (1.13 trillion). Defence accounts for bulk of capital expenditure of the government.

With an ambitious target of achieving self-reliance in defence production with the aim of reducing huge defence import bill, the government had made public its intention in the Press Conference held on May 16, 2020, wherein a roadmap was revealed in this regard in the form of a presentation titled "Atma Nirbhar Bharat- Part 4: New Horizons of Growth". In the presentation of May 16, 2020, the government aimed to inter alia achieve indigenization of imported spares, separate budget provisioning for domestic capital procurement, besides its wish to notify a list of weapons/ platforms for ban on import with year-wise timelines.

The size of the Defence Industry, including Aerospace and Naval Shipbuilding Industry, is currently estimated to be about INR 80,000 Cr (2019-20) [800 billion], where the contribution of Public Sector is estimated to be INR 63,000 crores (630 billion). Significant efforts have been made to ease the licensing/ investment processes to allow participation of the private sector.

The Government's vision is to achieve self-reliance and exports in Defence sector with active participation of public and private sector from design to production. **With self-reliance as the motto, the aim is to move away from licensed production to Design, Develop and Produce, wherein the Nation owns the Design Rights and IP of the systems**.

In line with the vision of "Atma Nirbhar Bharat", the Ministry of Defence (MoD) has formulated a draft **Defence Production and Export Promotion Policy, 2020 (DPEPP 2020)** as an overarching guiding document to provide a focused, structured and significant thrust to defence production capabilities of the country for self-reliance and exports.
The draft DPEPP 2020 has laid out the following goals and objectives:

a. To achieve a turnover of INR 1,75,000 Crores (US$ 25Bn) including export of INR 35,000 Crore (US$ 5 Billion) in Aerospace and Defence goods and services by 2025.

b. To develop a dynamic, robust and competitive Defence industry, including Aerospace and Naval Shipbuilding industry, to cater to the needs of Armed forces with quality products.

c. To reduce dependence on imports and take forward 'Make in India' initiatives through domestic design and development.

d. To promote export of defence products and become part of the global defence value chains.

e. To create an environment that encourages R&D, rewards innovation, creates Indian IP ownership and promotes a robust and self-reliant defence industry.

The Policy brings out multiple strategies which *inter alia* include Procurement reforms, Indigenization, support to MSMEs/ Start-ups, etc. to achieve the aforesaid goals as under:

1. **Procurement Reforms**: For capital procurement, changes have been proposed in the Defence Procurement Procedure and are being notified. Similarly, for revenue procurement, revision is in process. Besides the above, for expanding the domestic defence manufacturing ecosystem, the following strategies are proposed:

   - Notifying a negative list of weapons/ platforms with year-wise timelines for placing an embargo on import of such items.

   - A comprehensive review and overhaul of the trials and testing procedures would be done to reduce the procurement cycle time of indigenously developed products/ systems.

   - All Acceptances of Necessity (AoNs) involving procurement from domestic sources would be reviewed for time-bound procurement.

   - Setting up Project Management Unit (PMU) to support the acquisition process and create focus and synergy in building military capabilities.

   To create a Technology Assessment Cell (TAC) which would make an assessment of the Technology Readiness Levels (TRL) available in the country for all the major systems/ platforms and provide advice for initiation of AONs taking note of the time frames needed for development, trials and induction of systems to avoid immediate procurement requests to the maximum extent. It would also assess the industrial capability for design, development and production including re-engineering for production of various major systems like Armoured Vehicles, Submarines, Fighter Aircraft, Helicopters, Radars with the major industries in the country.

2. **Indigenization and support to MSMEs/ Start-ups**: The draft DPEPP 2020 policy is aimed at creating an industry ecosystem to indigenize the imported components (including alloys and special materials) and sub-assemblies for defence equipment and platform manufactured in India. **5,000 such items are proposed to be indigenized by 2025**. In order to achieve this objective, following strategies are proposed:

   a. Support will be provided to MSMEs/ Startups/ Industry through

indigenization portal for import substitution.

b. Processes will be strengthened to make it easier for the industry to provide indigenous solutions.

c. Inter-Governmental processes would be taken forward to indigenize spares and components for legacy platforms and equipment.

d. Public Procurement Order will be made applicable for procurement preference to those items in Defence sector for which domestic production capability exists.

e. Defence Investor Cell will provide handholding to MSMEs, investors and vendors in defence production for resolving issues with Central, State and other authorities.

f. Vendor Development would be taken up by Ordnance Factories/ Defence Public Sector Units (DPSUs) and use of TreDS platform would be mandated for improving their liquidity and timely payments.

g. Long term orders to incentivize the domestic industry in case of the critical products and materials currently being imported, along with the provision for repeat order.

h. Services will hand-hold the industry through continuous interactions, sharing of information and arranging visits to repair establishments/ field depots for better understanding/ appreciation of the requirements.

3. The share of domestic procurement in overall Defence procurement is about 60 per cent. In order to enhance procurement from domestic industry, the target is to double the procurement from the current INR 70,000 crore to INR 1,40,000 crore by 2025 by enhancing allocation for domestic capital procurement at the rate of minimum 15 per cent per annum for the next five years, besides OFB/ DPSUs increasing productivity with greater vendor outsourcing at all levels and at reduced costs.

4. **Investment Promotion, FDI And Ease of Doing Business**: India is already a large aerospace market as a result of which the demand for aircrafts (fixed and rotary wings) is increasing in the segment of Aircraft Build Work, Aircraft MRO, Helicopters, Engine manufacturing and MRO work, Line Replaceable Units (LRUs), Unmanned Aerial Vehicles (UAVs), Upgrades & Retrofits. Investments would be encouraged to provide specific focus on these identified segments and technological areas. The investments in these segments would also be channelized by offering high multipliers through offsets obligations.

Considering the future potential and current scenario, efforts would be made through appropriate skill development and technology upgradation to diversify automotive component manufacturers and other similarly relevant industries to aerospace components design and manufacturing. Efforts would also be made to attract investments for development of technologies and systems relating to missiles, radar systems, fighter aircrafts, main battle tanks, rocket systems, under water systems, Naval systems, communication systems, electro optic systems, EW systems, etc. and bring them to a level of maturity.

FDI would be attracted through Invest India and Defence Investor cell.

Licensing process for defence industries would continue to be eased by obtaining regular feedback from the industry and

disposal of applications in a time bound manner.

5. **R&D and Innovation**: In respect of R&D and innovation, DRDO, in consultation and collaboration with other scientific and industrial establishments, would set up missions in select areas to develop futuristic and critical systems/ platforms/ materials.

6. **Export:** In order to achieve the target of INR 35,000 crore (US$ 5 Bn) of Defence Exports by 2025, domestically manufactured defence products will be promoted through Govt to Govt agreements and Lines of Credit/ Funding, subject to strategic considerations. DPSUs and OFB would be mandated to have at least 25% of their revenue from exports including success fee earned as target by 2025.

   Export Promotion Cell set up to promote Defence exports through coordinated action to support the Industry, would be further strengthened and professionalized.

   In collaboration with the Industry associations, DDP would facilitate on boarding of Indian Offset Partners (IOPs) in the discharge of offset obligations by OEMs.

7. Besides the above, Ordinance Factories and DPSUs Ordinance factories will be corporatized to make them competitive and to improve their productivity, and OFB/ DPSUs will be mandated to maximize outsourcing from indigenous sources.

8. DPSUs will be positioned as system integrators and create a multi-tier domestic supply chain. Disinvestment of DPSUs will be pursued.

9. Testing facilities of DGQA/ DGAQA/ DRDO will be upgraded by establishing test rigs/ environmental test chambers, able to simulate actual operational conditions. The existing testing infrastructure with Defence organizations would be made available for private industry use on equal priority. Efforts would be made to create testing infrastructure through Defence Testing Infrastructure Scheme by providing assistance to industry to set up common testing facilities.

The government's Press Release dated August 3, 2020 has invited inputs/comments from the stakeholders, based on which the policy would be promulgated by MoD.

The Government has already started taking steps towards self-reliance. The MoD has bifurcated the capital procurement budget for 2020-21 between domestic and foreign capital procurement routes. A separate budget head has been created with an outlay of nearly INR 52,000 crore (520 billion) for domestic capital procurement in the current financial year.

Recently, the government has notified a negative list of 101 items which comprises of not just simple parts but also some high technology weapon systems like artillery guns, assault rifles, corvettes, sonar systems, transport aircrafts, light combat helicopters (LCHs), radars and many other items. The embargo on imports is planned to be progressively implemented between 2020 to 2024. More such equipment for import embargo would be identified progressively by the Department of Military Affairs.

With this ban, it is estimated that contracts worth almost INR Four Lakh Crores (4 trillion) will be placed upon the domestic industry within the next five to seven years.

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Goods and Services Tax

Taxability of Marketing and Consulting Services

M/s DKV Enterprises Pvt Ltd [AAR No 04/AP/GST/2020 dated 24.02.2020 (Andhra Pradesh)

The Hon'ble Andhra Pradesh Authority of Advance Ruling in its recent ruling in the matter of **"**DKV Enterprises Private Limited" has held that 'marketing and consultancy services' provided by the applicant to overseas client would be classified as 'intermediary services' and not an 'export of service'.

The facts of the case are that the applicant is providing marketing and consultancy services for the supply of goods from Grace Davison (Singapore) to the specific Indian clients of Grace Davison. In other words, the applicant was promoting sale and soliciting orders for products in accordance with the marketing plans and objectives of Grace. Further, as compensation for its services, applicant was earning commission on the sale of products in India. Commission was being calculated as a certain percentage of net sale price of goods sourced.

It may be mentioned that in terms of Section 2(6) of the IGST Act, 2017, intermediary means *a broker, an agent or any other person, by whatever name called, who arranges or facilitates the supply of goods or services or both, or securities, between two or more persons, but doesn't include a person who supplies such goods or services or both on his own account.*

The Advance Ruling Authority held that services rendered by Applicant, i.e. M/s DKV ought to be classified as Intermediary services and not as Export of services on the following grounds:

a) Supply of goods is taking place directly from Foreign Supplier to Indian Customer and the supply of goods is not taking place on account of the Applicant, i.e. M/s DKV.

b) M/s DKV is only acting as a facilitator of sale between two parties.

c) Consideration received by M/s DKV is contingent upon successful supply of goods.

d) Consideration is calculated as a certain percentage of net sale price of goods sourced.

Hence, the said transaction would qualify as "Intermediary Service". Since the place of supply of services in case of Intermediary services is the location of service provider, which in present case is India as M/s DKV is located in India, the services would be eligible to GST at the rate of 18%.

Taxability of Salary cost of Expat Employees by Project Office

Hitachi Power Europe GmbH [ARA No 38/2019/B-19 dated 11.03.2020 (Maharashtra)]

The Hon'ble Maharashtra Advance Ruling Authority recently held that GST would not be applicable on the accounting entry made for the purpose of Indian accounting requirements in the books of account of the

Project Office for salary cost of Expatriate employees which is paid by the Head Office for the administrative convenience purposes.

The facts of the case are that Hitachi Power Europe GmbH (hereinafter referred to as '**HO**') had been awarded a contract for supply of goods and supervision services in India by Indian entities. For execution of the onshore portion of the Project, HO had set-up a Project office ('**PO**') in India.

Few employees of HO work in the PO as Expat employees, for whom all employer related compliances are being taken care by Indian PO as required under Indian laws. Since, for most Expat employees, their primary bank account is located outside India, salary is paid to these employees by HO from HO's Bank Account located outside India, for administrative convenience purposes only.

Further, for due compliance as required under the Companies Act, 2013 and Income-tax purposes, in order to show true and fair view of business in India, PO is required to maintain its financial books of account in India and pass an accounting entry in its financial books of account in India for the salary cost of the Expat employees.

The accounting of Salary cost is made for the purpose of compliance under Companies Act and PO is not obligated to make any remittance to the HO towards such cost. Further all the Income tax compliance requirements, such as deduction of TDS and issue of Form 16 is done by PO only.

The Advance Ruling Authority held that GST would not be applicable on the accounting entry made for the purpose of Indian Accounting requirements in the books of PO for salary cost of Expat Employees on the following grounds:

a) As per RBI Guidelines, a Foreign Company can establish a PO in India either on temporary basis or permanent project office, provided the Foreign company has been awarded a project to be executed in India. A PO represents the interest of Foreign Company executing a project in India and undertakes commercial activities related to a particular project.

b) PAN and TAN is allotted to PO in the name of HO situated abroad by the Income Tax Authorities. Also, PO has its own employees as well as Expat employees, for whom all the employer related obligations such as Form 16 under Income-tax Act are done by PO.

c) The Advance Ruling Authority held that PO is an extension of Foreign HO. PO carries out all activities relating and incidental to execution of project in India. **Thus, Advance Ruling Authority held that expat employees are employees of HO and since PO is an extension of HO, there is a relation of employer-employee between PO and the expat employees.**

d) The Advance Ruling Authority further held that though for GST to be applicable on the accounting entry made for the purpose of Indian Accounting requirements in the books of account of PO for salary cost of Expat employees paid by HO, such accounting entry should be seen as a supply of services, however, due to employer-employee relationship between PO and Expat employees, under the provision of Schedule III of CGST Act, the said services would not be covered under the scope of levy of GST.

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General Updates

- The due date for filing Form GSTR 4 for the financial year 2019-20 has been extended to August 31, 2020.

- Goods & Services Tax Network has proposed the following changes in existing returns i.e. GSTR 1, GSTR 2A and GSTR 3B for ease of doing compliances for taxpayers:

  (a) Delinking of Credit/ Debit note and amendments thereof from original tax invoice. Therefore, taxpayer shall not be required to report original invoice details along with details of Credit/ Debit note at the time of filling of GSTR 1/ GSTR 6.

  (b) B2CL transactions will be merged with B2CS transactions.

  (c) Some inclusions in Form GSTR 2A for the ease of performing reconciliations:

    - Date of filing of GSTR 1 by the supplier.
    - Status of GSTR 3B of the supplier.
    - Period of tax invoice.
    - Detail of Import of goods, purchase made from SEZ to be auto populated in Form GSTR 2A.
    - Amendment flag in respect of invoices, if any.

  (d) Auto-computation of tax liability in GSTR 3B based on GSTR 1 filed by the taxpayer.

- **E-invoicing under GST Law**

  The Central Board of Indirect Taxes and Customs (CBIC) has notified e-invoicing for businesses with aggregate turnover in a financial year exceeding INR 500 Crores, thereby increasing the threshold for mandatory issuance of electronic invoices from the earlier limit of INR 100 Crores to provide relief to small scale companies.

  Furthermore, as per the notification dated July 29, 2020, Special Economic Zone (SEZ) units are not required to follow e-invoicing rules.

  E-invoicing for B2B transactions will be implemented from October 1, 2020.

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Important dates to remember

Particulars	Date
Deposit of TDS for the month of August, 2020	07.09.2020
Filing of GSTR I for the month of August, 2020	11.09.2020
Filing of GSTR 3B for the month of August, 2020	20.09.2020