NAGPUR BRANCH OF WIRC OF ICAI

E- Newsletter

May 2017

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CHAIRMAN's MESSAGE

CA. SANDEEP JOTWANI
Chairman, Nagpur Branch of WIRC of ICAI

At the outset let me wish you a very Happy New Financial Year. This new financial year will be very Important and Challenging for the profession looking to the new opportunities like Goods & Service Tax (GST), Real Estate Regulation & Development Act, 2016 (RERA), and various new compliances under the existing Laws. Apart from these, the Provisions of General Anti Avoidance Rule (GAAR) are made effective from 01st April, 2017. Looking to these challenges and opportunities various programs are organized by Nagpur Branch for the benefit of profession.

Major Programs

We started the New Financial Year by felicitation of Dr. Subramanian Swamy, MP (Rajya Sabha) and discussed with him various issues with regard to professional interest. Looking to the various issues being shared by our members with regard to GST Migration, we have organized special GST Migration Camp jointly with the Central Excise, Customs & Service Tax Department officials which was followed by Press Conference wherein Chief Commissioner Shri A.K Pandey along with other senior officers was personally present to create awareness amongst the public with regard to the new law. We were also privileged to have Shri Sanjay Bangartale, Dy. Director of Enforcement Directorate as Chief Guest for Half Day Seminar on PMLA & Benami Transaction Act. The First Batch of Intensive Study Course on GST for Beginners inaugurated by Shri P.K. Agrawal, Jt. Commissioner of Sales Tax was a grand hit after which there is huge demand to have such series in future as well.

Program on GST

Looking to the demand of our members and the need of the hour, we are planning to organize number of Mega Programs along with Intensive Courses for our members. We understand that the backbone of any office is the staff members and the articles who also should be trained for the proper execution of work. We are planning various programs for them as well. It is our duty as a Partner in Nation Building to take all efforts to help the Government to smoothly implement the GST Law which will have a major impact in our economy. Our members are visiting at various places and speaking at various programs organized by Trade & Industry and trying to explain the common public the effects of this new law. Our city will witness a major program on 16th & 17th June, wherein speakers of National Repute CA. Madhukar Hiregange, Central Council Member, CA. J.K. Mittal, CA. Naresh Sheth, CA. P. Rajendra Kumar, CA. Sunil Gabhawalla & CA. Rajat Talati will be addressing our members on various topics of GST.

International Taxation

We are living in a world where distance is not the barrier. It is important to go beyond and look for opportunities across the globe. One of such major opportunity is International Taxation. International Taxation in a simple language means the study of Taxation beyond the National Level. Though we are well conversant with our Indian Laws but considering the present scenario let's go beyond and understand the law at the next level as well. This issue is totally dedicated to International Taxation and we hope this small effort will be of immense benefit for our members as well as students.

Series of Intensive Courses

Intensive Course have proved to be very successful and looking to the feedback received after the first course, apart from Intensive Course on GST for Beginners, we have also planned Intensive Study Course on MS Office, Intensive Study Course on Companies Act, 2013 and Intensive Study Course on Auditing & Assurance Standards.

A request to members to please contribute your views and suggestions to organize programs for the benefit of members and students. Also a small request to contribute your articles for the newsletter on topics of professional interest.

"आओ चले एक साथ – Lets Illuminate"

With Kindest Regards,
CA. Sandeep Jotwani
Chairman
Nagpur Branch of WIRC of ICAI

RCM's MESSAGE

CA. ABHIJIT KELKAR
RCM-WIRC

Namaskaar !!!

Change is inevitable. The only constant thing we are experiencing is "change". We have to brace ourselves against constant changes in the professional accounting world, be it new GST or changes in taxation etc. Unlike the other professions of medicine or engineering CA has some uniqueness. It is unique in the sense it has to cater to the diverse, different and at times opposing needs or expectations of different groups/ services recipients like the government, clients and the public at large at the same time. At times a CA may be called upon to report against his clients from whom he takes fees as remuneration which is his livelihood. This requires grit, determination and an inner zeal to uphold the professional ethics. Let us resolve to uphold the highest of integrity in discharging our professional assignments. Let us resolve to upgrade our professional skills and knowledge which is essential to raise the standard of our professional services.

Wish you all the very best

CA. Abhijit Kelkar
RCM-WIRC

JOINT EDITOR's MESSAGE

CA. DEEPAK JETHWANI
Joint Editor

Globalisation of economies is seeing companies with multi country operations in increasing numbers. Increase in the number of cross border transactions, mergers & acquisitions, transfer pricing, tax treaties etc. have made the need to know the International Tax Laws. In its continuous effort of Nagpur Branch and to achieve the inclusiveness of theme " चले एक साथ – Lets Illuminate" this issue of Branch Journal is focused on different issues of International Taxation. There are plentiful of professional opportunities available for the person who masters in this, as there are only few chartered accountants who are practicing in this area.

Beside International Taxation, GST and Real Estate Regulatory Act (RERA) are currently the hot topics. In this issue a brief on Registration under RERA is covered.

I request members to kindly contribute their expertise and share their knowledge of different Government schemes and Incentives available with all through writing articles in the newsletter of June at nagpur@icai.org.

Keep writing, keep sharing, Lets Illuminate.

Awaiting your feedback and suggestions on the newsletter...

CA. Deepak Jethwani
Joint Editor

JOINT EDITOR's MESSAGE

CA.ASHISH AGRAWAL
Joint Editor

A new financial year begins with hectic schedule, as bank audits and various due dates for filing returns & payment of Taxes were in this first month. Inspite of this busy schedule of members' branch has organized various programmes for the overall benefit of members.

GST is the current hot topic, and as we heading towards the month of July 17 the need to update ourselves with this GST Laws is increasing, and to cater this Nagpur Branch has organized a series of workshops on this GST law & these workshops got the overwhelming response from the members.

Updating our knowledge is one of the important activities of our members, so as to update our readers regularly, we have in this issue developments and updates in various laws like International Taxation, Base Erosion and profit Shifting And RERA.

As we all know that summer season is started and it's time to take a break from our busy routines and to go out for a vacation on some nice outdoor destination. Looking forward to this Nagpur branch is taking all the efforts in organize a residential refresher course on one of the beautiful location of North India so as our member can rejuvenate themselves and spend quality time with family and friends.

We congratulate all the members who have been co-opted as members of various committees of Nagpur Branch & WIRC of ICAI.

With Warm Regards

CA. Ashish N Agrawal
Joint Editor

INTRODUCTION TO BASE EROSION AND PROFIT SHIFTING (BEPS) - INDIAN RESPONSE TO BEPS

- CA. ABHIRAM DESHMUKH

We are a witness to blurring of geographical borders so far as Economic activities are concerned. Governments are finding it increasingly difficult to deal with the expectations and aspirations of its subjects without being open to the world economy. That is the important reason for increasingly promoting cross border economic activity. Enterprises are on a hunt for a market for their goods and services and consumers want the best at the most completive prices. All these are contributors to the growth of world trade and growth of Multinational enterprises (MNE). These enterprises have to deal with jurisdictions in which they operate and have to adhere to the laws of those states. Direct taxes in these jurisdictions are charge on profits of the enterprise. It may so happen that a certain income may get taxed twice once in the source jurisdiction (due to withholding provisions) and later in the jurisdiction of the residence of the MNE. Governments are providing relief to MNE's from the rigors of double taxation by entering into treaties so as to avoid Double Taxation of incomes of multinational enterprises (Double Taxation Avoidance Agreements DTAA).

MNE's structure their business in a fashion so that the incidence of Direct tax is greatly reduced taking advantage of the DTAA. While it would be perfectly legal to do so, many times the structuring is done by artificially shifting profits from high tax jurisdictions to low or no tax ones. The gaps in the international tax rules are exploited which result in undesirable situations of Double non taxation of incomes of MNE's.

Revenue losses from exploitation of gaps in international tax rules (Tax treaties) by MNE's are conservatively estimated at between USD 100 billion and 240 billion annually. This is equivalent to between 4% and 10% of global revenues from corporate income tax.

Digital commerce has posed challenges to the traditional ways of establishing connection with the economic activity of an enterprise in a particular state. The geographical nexus with the state was the basis of taxing income of an enterprise in that state in whose economy it has participated. In Digital commerce an enterprise can generate revenues in a state where it has no presence and hence the state would loose its fair share of taxes on such income generated by the MNE if it sticks to traditional ways of taxing an enterprise.

To address these issues The Organization for Economic Cooperation and Development (OECD) states has embarked on a project of Base erosion and Profit Shifting (BEPS) and formulated BEPS Action plan in 2013. The overall aim of the BEPS measures is to close gaps in international tax rules that allow multinational enterprises to legally but artificially shift profits to low or no-tax jurisdictions.
In 2015 OECD has come out with 15 Action plans. BEPS action plans are directed to limit, restrict and prohibit erosion of tax bases and shifting of profits.
The plans are enlisted as under:-

1) Addressing the tax challenges of Digital Economy
2) Nutralising the effects of Hybrid mismatch arrangements

3) Strengthening CFC rules
4) Limit base erosion involving interest deductions and other financial payments
5) Countering harmful tax practices more effectively taking into account transparency and substance.
6) Prevent Treaty Abuse.
7) Prevent artificial avoidance of Permanent Establishment status.
8) Aligining transfer pricing outcomes with Value creation- Intangibles
9) Aligining transfer pricing outcomes with Value creation- Risks and Capital.
10) Aligining transfer pricing outcomes with Value creation- Other High risk transactions.
11) Measuring and Monitoring BEPS
12) Disclose Aggressive tax planning arrangements
13) Transfer pricing documentation and country by country reporting.
14) Making dispute resolution more effective.
15) Develop Multilateral Agreements.

BEPS action points stem from principles such as substance over form, alignment of taxation with value creation, transparency and certainty. BEPS lays down certain new rules which have to be implemented by the states

Till date 35 countries have signed BEPS Action plan. India is yet to sign however some of the action points have already found place in the Indian direct tax legislation and others will be incorporated in due course of time.

Indian response to BEPS can be gauged from amendments to the Income Tax Act, 1961

1) In line with BEPS Action 1 (Addressing the tax challenges of Digital Economy)

Equalization levy is introduced at the rate of 6 percent on cross-border payments for online advertisement services, where the non-resident service provider does not have a permanent establishment in India.

2) In line with BEPS Action 4 (Limit base erosion involving interest deductions and other financial payments)

The budget introduces new restrictions on interest deductibility (thin capitalization rules) in line with the OECD base erosion and profit shifting (BEPS) project, among other tax measures.
Budget introduces a cap on the total interest deduction to 30% of a company's earnings before interest, taxes, depreciation and amortization. The cap applies to interest paid or payable to non-resident associated enterprises by an Indian company or a permanent establishment of a foreign company in India. Any interest that exceeds the cap is disallowed under the new rules, but may be carried forward up to eight years and qualify for a future deduction. Taxpayers engaged in banking or insurance businesses

interest, taxes, depreciation and amortization. The cap applies to interest paid or payable to non-resident associated enterprises by an Indian company or a permanent establishment of a foreign company in India. Any interest that exceeds the cap is disallowed under the new rules, but may be carried forward up to eight years and qualify for a future deduction. Taxpayers engaged in banking or insurance businesses will not be affected by the new rules, which will be applicable beginning in financial year 2017-18.

3) In line with BEPS Action 13
(Transfer pricing documentation and country by country reporting)

Union Budget 2016-17 proposes that every Indian entity that is a subsidiary or permanent establishment of a foreign parented or headquartered multinational company group shall disclose the name and country of residence of its ultimate parent entity to the Indian tax authorities. The Indian authorities would then obtain the group's country-by-country report from the tax authorities of the parent's company of residence under a mutual exchange of information arrangement.

4) In line with BEPS Action 8 to 10
(Secondary adjustment)

Adjustment made in transfer price would trigger secondary adjustment. If an adjustment to the transfer price - Arms Length Price (ALP) has the effect of increase in the profit/reduce loss for the Indian entity then the benefit which has passed on to the associated entity outside India would have to be brought back in India. The secondary adjustments that are incorporated in the domestic legislation in section 92 CE are those which have attained finality i.e the tax payer has accepted the same. (suo moto by tax payer or after being done by the tax officer and accepted by the tax payer or after Advance Pricing Agreement or after resolution of Mutual Agreement procedures)

We would see increased action on BEPS action plan in the coming years all over the globe. India cannot be left behind. A study of the action points would give a precursor to the things to come.

Some of the terms used above are explained hereunder

a) Hybrid mismatch arrangements:-

Hybrid means a mix. There can be two kinds of hybrids, one is on entity level and other on transaction level. On entity level it pertains to opacity of entities (Beneficial ownership cannot be ascertained) for tax purposes. On transactional level same transaction is treated differently (as debt or equity for instance) by different countries. This results in tax benefits accruing to an enterprise.

b) CFC:- Controlled financial corporations

The corporate entities incorporated in a country but the control in is a different country.

c) Transfer Pricing:-

Price at which products and services are transferred to associated enterprises (entities having common control or one being controlled by another).

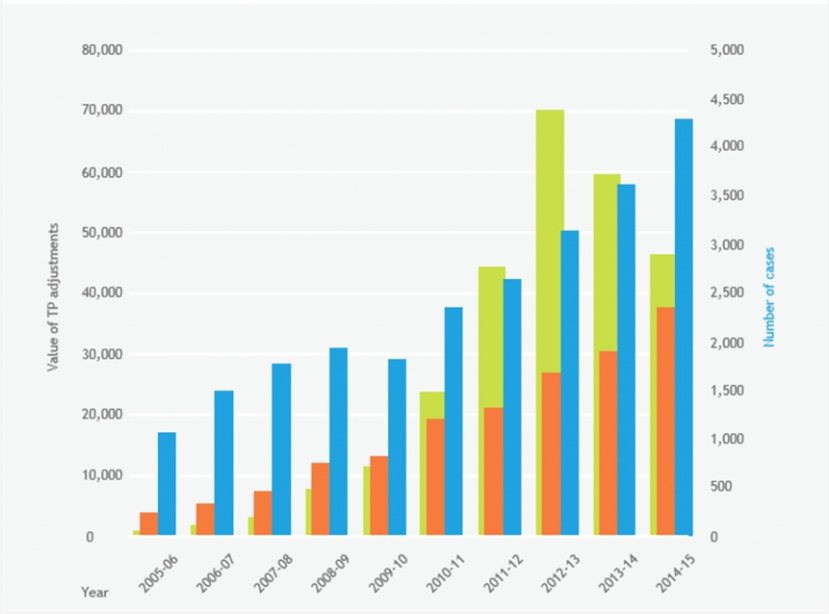
THE TANGIBLE CONTROVERSIES ON MARKETING INTANGIBLES

- CA. ASMA SADQUEVALI CHIMTHANAWALA

In the midst of an uncertain global economic outlook, India is emerging as the new global economic hotspot' according to International Monetary Fund. The Indian economy is estimated to have grown at 7.6% in FY 2015-16 and is expected to grow at 7% to 7.75% in FY 2016-17, making it the fastest growing major economy in the world. For this purpose, it is imperative that India's cross border and transfer pricing regime is investor friendly and reduces potential and frivolous litigation. The Indian transfer pricing regime had been considered to be one of the most aggressive in the world with spate of litigation. A slew of measures have been taken by the government in the recent past leading to introduction of range concept, use of multiple year data in benchmarking, etc. Further, at a global level as part of G20, India was involved in the BEPS project. In the Budget of 2016 the finance minister introduced BEPS Action Plan 13 which includes provision for requirement of country by country reporting for companies with consolidated revenue of more than Euro 750 million which are applicable from AY 2017-18.

The TP provisions in India are in existence for almost 15 years and have generated considerable controversies – including retrospective amendments. The latest estimates suggest that the tax authorities have made an upward adjustment to the income of the assessee to the tune of more than INR 2700 billion (US$ 40billion) since inception of TP Regulations in India. The Finance Minister also highlighted in his budget speech that the overall tax demand of more than INR 5.5lakh crores is under dispute and litigation. It is understood that roughly 50% of the above tax demand relates to transfer pricing disputes. Indian tax has been ranked 2 amongst toughest tax authorities in the world.

TP adjustments - last 10 years India has more number of TP rulings (over 1,800 reported TP rulings as on date) than most other countries in the world where TP law has been in existence for several decades prior to introduction of this law in India in 2001. The TP litigation, which has occurred in last decade consistently shows an upward trend, as evident from the chart below -



Amt. of Adjustments (in cr.)	1,220	2,287	3,432	7,754	10,908	24,111	44,532	70,016	59,602	46,466
No. of TP audits completed	1,061	1,501	1,768	1,945	1,830	2,368	2,638	3,171	3,617	4,290
No. of adj.cases	239	337	471	754	813	1,207	1,343	1,686	1,920	2,353

Amt. of Adjustments (in cr.) No. of TP audits completed No. of adj.cases

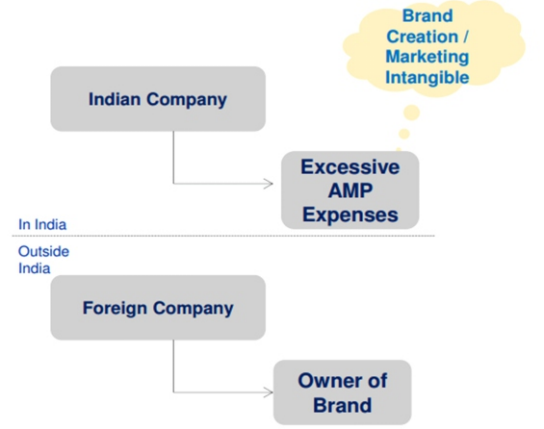
Note: The values in orange colour above represent the number of cases where TP adjustments have been made.

Source: Statistics appearing in Annual Reports 2013-14 and 2014-15 published by Ministry of Finance

In the recent round of TP audits in India, the tax payers have experienced aggressive approach by the Transfer Pricing Officers (TPO's) where it is alleged that the AMP expenditure incurred by the Indian AE results in an enhancement of the value of the brand / trademark belonging to the foreign AE and therefore an appropriate compensation is required to be made to the Indian AE. Accordingly, the Indian AE ought to get an arm's length compensation.

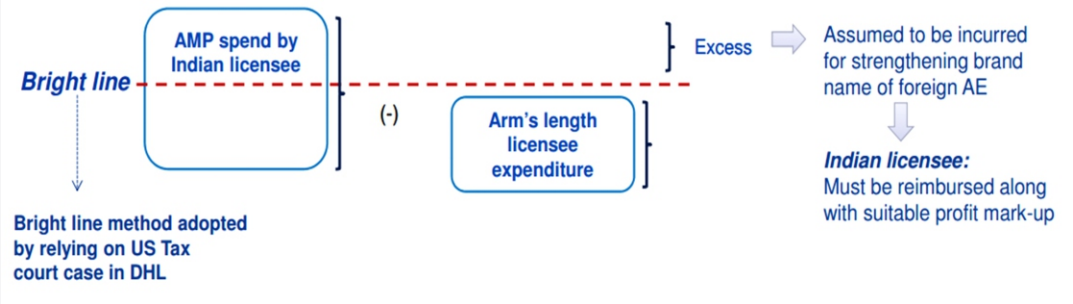
Marketing intangibles have become a hotly debated topic within the transfer pricing community in different countries. Generally, the term marketing intangibles and its value is derived from the company's levels of AMP expenses.

- These are created by the enterprise that invests to give market recognition or value to the brand. While the increased brand value at a local level may benefit the local entity only, it may not have the right to future perpetual intangible benefits arising from it.



- Hence, the tax authorities seek to identify and differentiate these spends that develop the intangible and provide enduring benefit over that of routine advertising costs. In these cases the international transaction is between taxpayer and associated enterprises (AE) where the taxpayer incurred Advertising Marketing Promotion (AMP) expenses towards marketing intangibles legally-owned by the AE; the issue herein pertains to allow ability of such AMP expenses in the hands of the taxpayer, considering the commercial rational or the legal ownership.

- The revenue authority's contention is that the entity that has incurred significant spends to generate these non-routine intangible needs to be compensated by its affiliates in other jurisdictions, if the benefit from such intangibles is flowing to the foreign affiliates which own the intangibles. According to the tax Authorities, what is relevant under the Transfer Pricing Regulations is legal ownership of intangibles.



In an early interesting decision, the US courts, in the DHL case, held that no royalty would be due to DHL US from its associated entity DHL International, standing for the proposition that for items of intangible property, the party which bore the economic burden of the investment should bear the economic rewards. Here, the trial judge espoused the 'bright-line' test which notes that, while every licensee or distributor is expected to expend a certain amount of cost to exploit the items of intangible property to which it is provided, it is when the investment crosses the bright line of routine expenditures into the realm of non-routine that economic ownership, probably in the form of a marketing intangible, is created.

However, to date the bright-line approach has been considered as more realistic to resolve the issue at hand though it is often used by tax authorities to their advantage. It would also be pertinent to note that recently the Committee on Fiscal Affairs of the OECD announced that Working Party No 6 is considering a new consultation project on the transfer pricing aspects of intangibles.

While the guidelines and court precedents fundamentally revolve around dividing AMP spends into routine and non-routine or applying the bright-line test, it is not possible to apply this uniformly because companies within the same industry have different marketing philosophies, business realities/features, product launches, product dependence or interdependence and may account for their marketing spends under different accounting heads, which would create different levels of AMP and different bright lines for each entity.

Now let us discuss the following judicial precedents in light of the Indian context:

LG Electronics: Special Bench decision to deal with legal issues not factual issues

TS-11-ITAT-2013(DEL)-TP

- Indian company, engaged in manufacturing of Electronic goods in India, is a subsidiary of a Foreign Company

- Indian Company incurs AMP expenses for marketing the goods produced in India

- Indian company has incurred AMP expenses which exceeds the Bright Line limit
- Excess AMP expenses incurred by the Indian Company is perceived to enhance the brand value of Foreign Company
- Indian tax authorities have contended that AMP expenditure incurred by a taxpayer at a level that exceeds the "bright line" is to be reimbursed by the foreign AE with a mark-up

Judicial Precedent

- Incurring of AMP expenses by the assessee towards brand legally owned by the foreign AE constituted a 'transaction' subject to TP provisions;
- Upholds use of Bright Line Test for determining cost / value of such transactions
- Under IT Act, it is legal ownership of brand that is recognized - Special Bench Majority View
- Matter on the quantification set aside to re-look at comparables and appropriate cost base

Sony Ericsson - Delhi High Court

- Delhi High Court in the Sony Ericsson Mobile Communication India Pvt. Ltd and several other connected matters ITA No. 16/2014:TS-96-HC-2015(DEL)-TP
- Characterizing AMP expenses as an international transaction subject to transfer pricing
- Distribution and marketing are intertwined functions and can be analyzed together as a bundled transaction
- Segregation of non-routine AMP expenditure using the bright line approach inappropriate
- For selection of comparables, intensity of AMP functions is critical
- 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
- Concept of 'economic ownership' of brand recognized
- The HC has appreciated that the issue of marketing intangibles requires an in-depth factual analysis, depending upon the functional, asset and risk (FAR)profile of each taxpayer and its AEs.
- A common dictum, on merits, which would apply across the board as per the LG ruling, has been dismissed by the HC.

It is now very pertinent to discuss that in the case of Maruti Suzuki India Ltd. vs. Commissioner of Income Tax, the Delhi High Court has pronounced a landmark ruling that Transfer Pricing Adjustment cannot be made on Advertising, Marketing and Promotion ("AMP") expenses incurred by a domestic manufacturer who has a license to use the brand of a foreign entity and that excessive AMP expenditure cannot be a basis for discerning the existence of an international transaction.

- The Indian company is a subsidiary of Suzuki Motor Corporation, Japan and has entered into license agreements with the parent company to manufacture car models, provide technical know-how and right to use Suzuki's patents, trademarks, etc. The taxpayer paid the parent a bundled royalty as the consideration.

- The TPO observed that the AMP expenses incurred were 1.87% of its turnover, whereas the average was 0.60% that was being incurred by comparable companies concluding that transfer pricing adjustment would be required, as excess expenditure must be regarded as being incurred for promoting the brand "Suzuki" owned by SMC, the foreign parent. The DRP upheld the addition made by the TPO.

- On further appeal, the Income Tax Appellate Tribunal relied on the ruling of the Special Bench in LG Electronics India Pvt. Ltd. v. ACIT and upheld the transfer pricing adjustment of the revenue department. Thereafter the taxpayer filed an appeal before the Delhi High Court.

Judicial Precedent – Delhi High Court

- the very basis of the Bright Line Test was negated by this very Court in an earlier case of Sony Ericsson Mobile Communications India (P.) Ltd. both for determining if there is an international transaction and secondly for the purpose of determining the ALP.

- opined that the revenue department must establish the existence of international transaction without use of the Bright Line Test.

- upon analysis of Sections 92B to 92F of the Income Tax Act, held that since there is no machinery provided in the Act to determine the existence of international transaction involving AMP expenses, excessive AMP expenditure could not be used as a basis for pointing to the existence of an international transaction.

- observed that under the Income Tax Act, 'international transaction' means, inter alia, a transaction "having a bearing on the profits, incomes or losses of such enterprises" and includes "a mutual agreement or arrangement" for allocation of any costs or expenses. Thus an 'agreement' or 'arrangement' or 'understanding' between the two entities must exist whereby one entity is obliged to incur AMP expenses to promote the brand of the other. Such an agreement is a necessary condition but the Revenue had failed to show any such 'arrangement' or 'understanding' between the two AEs.

- the taxpayer's AMP spending was only 1.87% of its sale whereas the parent's AMP expense worldwide was 7.5% of sales and therefore this belies the possibility of any 'arrangement' or 'understanding' between the taxpayer and the foreign parent.

- The Court further placed reliance on the decision of Sony Ericsson (supra) and Rule 10B to hold that if the Indian entity had satisfied the Transaction Net Margin method i.e. the operating margins of the Indian enterprise are much higher than the operating margins of the comparable companies, no further separate adjustment for AMP expenditure is warranted.

- The Delhi High Court has also subsequently held in cases relating to those taxpayers, namely, Whirlpool of India Ltd, Honda Siel Power Products Limited, Bausch & Lomb Eyecare India P Ltd, who are either manufacturers or engaged in manufacturing as well as distribution activity that where the existence of an international transaction involving AMP expense with an ascertainable price is unable to be shown to exist, even if such price is nil, the transfer pricing provisions under Chapter X of the Act cannot be invoked to undertake a TP adjustment exercise.

- This judgment is a significant development on the dispute relating to benchmarking of marketing intangibles resulting from AMP expenses incurred by multinational corporations who operate as a licensed manufacturer. The ruling lays down important principles on the creation of marketing intangibles through services rendered by domestic manufacturers. The Delhi High Court had earlier ruled upon the issue of marketing intangible adjustment in case of Sony Ericsson Mobile Communications India Pvt. Ltd and others who were all distributors of products manufactured by foreign associated entities.

Key take ways are as mentioned below:

- The contention that AMP activities were not an international transaction had to be rejected. The arm's length determination pertains to the adequate compensation to the taxpayer for performing functions of marketing and incurring non-routine AMP expense in India.

- High Court provided substantial guidance on how to approach the issue of marketing intangibles, and highlighted that it is incorrect to state that AMP activities were directly attributable to brand building of the associated enterprise. Also, it held that benefit in the form of increase in sales could not be ignored.

- In the LG Electronics case, bright-line test was applied to determine the excessive AMP expenditure incurred for brand building. High Court held that it was unwanted, and hence rejected the application of bright-line test.

- High Court recognized the concept of economic ownership of intangible as the essential factor to arrive at an appropriate transfer price. "Economic" and "Legal" ownership may overlap at times basis the organizational structure/ factual arrangement within a corporate group."Legal ownership" of intangibles by an associated enterprise alone does not determine entitlement to returns from the exploitation of intangibles. Brand value is created by synergetic impact of

reputation, quality and other facts relevant to a particular business and not just by incurring AMP expense.

- Associated enterprises performing important value-creating functions related to the development, enhancement, maintenance, protection and exploitation of the intangibles can expect appropriate remuneration;

- An associated enterprise assuming risk in relation to the development, enhancement, maintenance, protection and exploitation of the intangibles must exercise control over the risks and have the financial capacity to assume the risks;

- An associated enterprise providing funding and assuming the related financials risks, but not performing any functions relating to the intangible, could generally only expect a risk-adjusted return on its funding.

- TNMM relies on the assumption that the functions, assets and risks are broadly similar, and that once suitable adjustments have been made, net profit margins should be compared. If the profit margin of the tested party matches with that of the comparables, it affirms that the transaction meets with arm's length standard.

- TNMM would not be an appropriate method in case of significant value addition by the Indian company, i.e., where the company is engaged in manufacturing activities, and also carrying out distribution and marketing activities.

- If on comparability analysis, gross profit earned by taxpayer is in line with the comparable margins earned by comparables carrying similar AMP function as that of the taxpayer, no further TP adjustment is warranted. In such cases, the gross profit margin includes the compensation for AMP expenses.

Although Indian TP Regulations do not specifically provide guidelines on intangibles, other than defining them as part of "international transaction" under section 92B, however since the Indian courts follow OECD, the judicial pronouncements are in line with OECD Guidelines. Where the Indian TP Regulations do not provide for a contrary provision, reliance on the OECD guidelines or the UN transfer pricing manual could be made.

A concluding word...

The Indian Revenue/TP authorities are implementing the ratio of the High Court decision and are scrutinizing existing as well as past cases (under Section 148 of the Indian Income-tax Act, 1961) where similar issues exist / arise. There are various approached being followed by the TPO's in quantifying the benefit from the AMP spend. One approach relates to using the Profit Split Method alleging that the foreign AE as well as the Indian AE are both involved in enhancing the value of the IPR and hence there should be an apportionment of global profits to the Indian AE. The other alternate method is to treat the

AMP expenses which exceed the bright-line test, to be a service by the Indian AE and adding a mark-up in the range of 10-15%. In either of the approach, the resultant adjustment in the hands of the Indian AE, more often than not, is huge. Also, the recent amendment enabling the TPO to bring into scrutiny any international transactions which he deems fit is a step to empower the TPO to bring into ambit transactions like AMP spends.

In light of the huge litigations and aggressive transfer pricing assessments, it is always judicial to take a conservative stand by assesses. The necessity of transfer pricing adjustment for AMP expenses may arise where there is influence of an AE in advertising and marketing function of the Indian affiliate. It is advisable for the taxpayer to evaluate the TP policy in light of detailed analysis of roles / responsibilities undertaken, risks borne / reward reaped. Also, a robust documentation including legal contracts etc. has to be maintained by the taxpayer .Nonetheless, taxpayers who are licensed manufacturers are advised to follow correct approach in line with fundamentals of TP, and leveraging upon relevant legal principles laid out in the Maruti ruling.

EVENT CLICKS

WICASA

CA Pavan Gahukar

CA Ashish Deolasi

RECENT DEVELOPMENTS IN INTERNATIONAL TAXATION

- CA. ROHAN LOYA

In this era of e-commerce, with the development of technology and globalization of businesses, Multinational Enterprises (MNEs) have started designing their business operations in a way to minimize their global tax costs through making effective use of tax rules and applicable exemptions available under tax treaties. On the other hand, International tax rules have not been able to keep pace with developments in the world economy, resulting in double non-taxation and stateless income. Due to aggressive tax planning strategies adopted by many large MNEs, there was a lot of hue and cry around morality of such harmful tax practices. As a result, Organization for Economic Co-operation and Development (OECD) started to shape out a plan to mitigate harmful tax practices to ward off the negative effects of MNEs' tax avoidance strategies on national tax bases. Keeping in pace with the global development in international tax practice, India adopted few steps in the Budget 2016 and Budget 2017. India introduced General Anti-Avoidance Rules (GAAR), Thin Capitalisation, Equalisation Levy, Secondary Adjustments in Transfer Pricing, strengthened the Country-by-Country reporting requirementsin the Transfer Pricing.

In the following paras, I would like to introduce you to Equalisation Levy, Thin Capitalisation & GAAR and their relevant provisions under the Indian law along with the basic understanding of why the above issues have gained so much importance in the tax world.

EQUALISATION LEVY

Background

In the commercial world we have seen a transformation of business from the traditional methods to the online methods. Today, all the business transaction, may it be to place an order or a payment or delivery of services are done through innovative web or mobile applications. This has given rise to new enterprises and entrepreneurs. Websites and applications like Amazon, E-bay, Alibaba, Flipkart, Snapdeal, MakeMy Trip, etc. have become major mediums by which transactions are carried out and have completely revamped the way business has been carried out.

Online advertising has also become as significant, if not more, than traditional modes of advertising like print, television, hoardings etc. Electronic modes have blurred the geographical boundaries and has made it difficult to identify the physical place/point where a particular activity in the chain of transactions which takes place in electronic commerce. With this, there is a possibility of shifting the profits to other jurisdiction or minimizing the taxable base in absence of physical presence and physical delivery. The original modes of doing business within countries by way of marketing subsidiaries, distributor subsidiaries, branches which traditionally created 'Permanent Establishment (PE)' is not a constraint in E-commerce and therefore, taxability in countries where the revenues arise is not necessarily a reality in an E-commerce scenario.

There are websites where one can access various services viz. content, news, e-mails, search

engines, chats, etc. These websites generate revenues from advertisement, etc. LinkedIn, Google, Facebook are few such websites which earn revenues through advertisement (generally under B2B model). The websites generally earn revenues from the advertiser based on number of clicks by a viewer on a particular advertisement. Advertisement agencies are hired by the Indian companies to display their advertisements on these portals owned by the non-resident companies. And this appears to be a normal way of income generation for an advertising company.

However as a commerce professional, we need to know what the tax implications due to this transaction are.The big question is, whether the payment made to non-resident companies for display of advertisement would be taxed in India? **The purchase of advertisement space on foreign website falls under business income. However, in absence of PE in India of the foreign search engine company, it cannot be said to accrue/arise in India, and hence not chargeable to tax in India.** It is evident to note that foreign company has earned the income from an Indian company, for providing advertisement space which will be mainly viewed by the Indian viewers. Still, the income has escaped tax in India. In order to curb this situation of non-taxation, the government introduced the concept of equalisation levy in Chapter VIII of the Finance Act, 2016.

Legal Provisions

Equalisation Levy (EL) is applicable to whole of India, except the state of Jammu and Kashmir from 1st June 2016. The provisions are stated below in brief:

- EL is a tax leviable @ 6% on gross consideration received or receivable by certain non-residents for specified services availed (> Rs. 1,00,000/- in a previous year) by specified payers.
- Obligation of collection, payment (7th of the next calendar month) and procedural compliances is on specified payers.
- Specified Payers means "an Indian resident carrying on business or profession" or "a non-resident having a PE in India."
- "Specified service" means online advertisement (eg. online advertising services rendered by Google or Yahoo or Facebook), any provision for digital advertising space or any other facility or service for the purpose of online advertisement and includes any other service as may be notified by the Central Government in this behalf.
- EL deduction is not applicable if the non-residentproviding serviceshas a PE in India and specified service is effectively connected with such PE. In such circumstances, the non-resident would be subject to tax on income of that PE as Business Income.

Examples in which EL not attracted:

- o If A, B, C & D (specified payers) make payment of Rs.95,000/- each to the non-resident in a previous year.
- o If A makes payment to 3 foreign companies of Rs.95,000/- each in a previous year.
- o If A makes payment of INR 95,000 in Year 1 and of Rs.95,000/- in Year 2 to Foreign Company.
- o Payment is not for the purpose of carrying out business or profession, i.e. if the transaction is not on B-to-B basis.

Parallel provisions in Income Tax Act, 1961

- Income arising to NR from the specified services and chargeable to EL is exempt u/s 10 (50).
- Any consideration paid or payable to a non-resident for a specified service on which EL is deductible and such levy has not been deducted or after deduction, has not been paid on or before the due date specified u/s 139 (1) shall be disallowed u/s 40 (a) (ib).

THIN CAPITALISATION

Background

"Capital" in commerce is generally understood as owned funds available with a person to carry on business activities. However, business today is also being carried on by availing debt funds. The way a company is capitalized often has a significant impact on the amount of profit it reports for tax purposes as the tax legislations of countries typically allow a deduction for interest paid or payable in arriving at the profit for tax purposes. Equity cost is in the form of dividends on which, there may be a withholding obligation or a dividend distribution tax (DDT) liability which has to be discharged as per provision of the law. Generally, payments of dividends are not allowed as a deduction while computing the taxable income of the taxpayer. So, higher the level of debt in a company, higher is the amount of interest it pays and lower will be the taxable profit. For this reason, debt is often a more tax efficient method of finance than equity. Multinational groups are often able to structure their financing arrangements to maximize these benefits.

Thin Capitalization refers to excessive use of debt over equity capital; this can be via hidden equity capitalization through excessive loans or the artificial use of interest-bearing debt instead of equity by **shareholders with the sole or primary motive to benefit from tax advantages.**

For this reason, country's tax administrations often introduce rules that place a limit on the amount of interest that can be deducted in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aim to protect a country's tax base. Under the initiative of the G-20 countries, the OECD in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in Action plan 4. The OECD has recommended several measures in its final report to address this issue.

In view of the above, Section 94B has been inserted in the Income Tax Act in line with the recommendations of OECD BEPS Action Plan 4.

Legal Provisions

Interest expenses or expense of similar nature, exceeding **Rs. 1 crore**, paid or payable by an entity to its associated enterprises (AE) shall be restricted to **30%** of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to AE, whichever is less. This amendment will apply in relation to the A.Y. 2018-19 and subsequent years.Other provisions are stated below in brief:

- Only interest which is deductible in computing income chargeable under the head "Profits and gains from business or profession (PGBP)" is governed by this section.
- The provision shall be applicable to an Indian company, or a PE of a foreign company in India, being the borrower, who pays interest in respect of any form of debt obtained by a non-resident who is an AE of the borrower. Further, the **debt shall be deemed** to be treated as issued by an AEwhere the AE provides an implicit or explicit guarantee to the lender or deposits a corresponding and matching amount of funds with the lender.
- The provisions allow for carry forward of disallowed interest expense upto8 A.Y's immediately succeeding the Assessment Year for which the disallowance was first made and to be allowed as deduction against the income computed under the head PGBP to the extent of the limit of maximum allowable interest expenditure.
- Business of banking and insurance are kept out the ambit of this section, due to the specific nature of business.

GENERAL ANTI-AVOIDANCE RULES (GAAR)

Background

For investing into India, Mauritius was considered to be tax efficient jurisdictions. Earlier, the tax treaty signed between India and Mauritius provided for a tax exemption on capital gains earned in India. Due to this specific provision in the DTAA, the companies from all around the world started routing their investment in India through sham companies incorporated in Mauritius. Questions were being raised on the morality of such tax planning. The companies were formed in Mauritius for the sole purpose of avoidance of capital gain tax and could not be supported by any other business reason to justify the tax structuring.

The two guiding principles in judicial anti-avoidance doctrine are "Business Purpose Rule" and "Substance over Form Rule." The "business purpose rule" says that a transaction must be justified from commercial point of view, other than serving a purpose of tax avoidance. Mere tax advantage cannot be the sole or main business purpose. The principle "substance over form" is wider in scope than "business purpose rule". 1987 OECD report defines it as "the prevalence of economic or social reality over the literal wording of legal provisions. Although substance test is being used very frequently, the true meaning of this test has remained unraveled. Though various countries have tried to define it by introducing GAAR provision or similar provision, it is rather impossible to codify it in its complete form as it being a very fact specific exercise." The question of substance over form has consistently arisen in the implementation of taxation laws. In the Indian context, judicial decisions have varied. While some courts in certain circumstances had held that legal form of transactions can be dispensed with and the real substance of transaction can be considered while applying the taxation laws, others have held that the form is to be given sanctity. In an environment of moderate rates of tax, it is necessary that the correct tax base be subject to tax. Most countries have codified the "substance over form" doctrine in the form of GAAR. Keeping in view the aggressive tax planning with the use of sophisticated structures, there was a need for statutory provision so as to codify the doctrine of "substance over form" **where the real intention of the parties and effect of transactions and purpose of an arrangement is taken into account for**

determining the tax consequences, irrespective of the legal structure that has been superimposed to camouflage the real intent and purpose. And hence GAAR is introduced in Chapter X-Ain the Income Tax Act to deal with this aggressive tax planning and has been made applicable with effect from assessment year starting from 1st April, 2018.

Legal Provisions

Section 95 empowers the tax authority, notwithstanding anything contained in the Act, to declare an arrangement which an assessee has entered into, as **"impermissible avoidance arrangement"**. Once it is declared as "impermissible avoidance arrangement", the consequence as regards tax liability would be determined. Tax authority has also power to declare,even a single step in or a part of that arrangement as impermissible avoidance arrangement. Other provisions are stated below in brief:

- GAAR not applicable
  - In cases where the tax benefit during the year does not exceed Rs. 3 crore in aggregate to all the parties to the arrangement.
  - In respect of income from transfer of investments made before 1st April 2017. Although it shall apply to the tax benefit obtained by such an arrangement on or after 1st April 2017.
  - To Foreign Institutional Investors (FIIs), who have not taken treaty benefits and has invested with prior permission of the competent authority.
  - To non-residents in respect of investments made in offshore derivative instruments in a FII.
- An impermissible avoidance arrangement can be identified with the two tests :
  - Main Purpose Test: The main purpose of which is to obtain a tax benefit.
  - Tainted Element Test: The arrangement must satisfy one or more of the below listed elements -
    - The arrangement creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;
    - Such arrangement results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;
    - Such arrangement lacks or is deemed to lack commercial substance, in whole or in part; or
    - Such arrangement is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.
- An arrangement shall be presumed to have been entered with the main purpose of obtaining tax benefit, where main purpose of even a single step or of part of that arrangement, is to obtain a tax benefit, notwithstanding the fact that main purpose of whole arrangement is not to obtain tax benefit. The onus to prove the contrary rests on the assessee (similar to Australia, Brazil, China, Ireland, Singapore and the United Sates).

- An arrangement is deemed to lack commercial substance if:
  - Its substance or effect is inconsistent with the form of its individual steps;
  - It involves round trip financing, accommodating parties, elements that offset/cancel each other or a transaction that disguises value, location, source, ownership or control of

funds;

- o It involves location of an asset or of a transaction or of a place of residence of any party without any substantial commercial purpose other than obtaining a tax benefit;
- o It does not have a significant effect upon business risks or net cash flows of any party to the arrangement.

• Factors for determining if an arrangement lacks commercial substance:

- o The period for which the arrangement exists
- o The fact of payment of taxes, directly or indirectly, under the arrangement
- o The fact that an exit route is provided for by the arrangement

• Few Consequences on invoking GAAR:

- o Denial of treaty benefits
- o Disregarding, combining, re-characterizing the arrangement
- o Treating the arrangement as if it had not been entered into
- o Disregarding accommodating parties and any other party as one and the same person
- o Reallocating income, expenditure, deduction, reliefs or rebates among parties to arrangement
- o Re-determining place of residence/location/situs of parties or assets
- o Looking through any arrangement by disregarding corporate structures
- o Re-characterizing debt as equity or vice-versa
- o Re-characterizing receipt of capital nature as revenue nature or vice-versa

• Section 90(2A) of the Act specifically provides that GAAR provisions will override tax treaty provisions even when they are more beneficial to the tax payer.

Although GAAR has now been introduced in the provisions of the Income Tax Act, the nature of GAAR enforcement will only be known in 2-3 years once the assessments for FY 2017-18 will commence.

There has always been a tug of war between the tax payers and the tax regulators. These issues which we have discussed above has come into picture because of a thin line difference between tax avoidance and tax planning. The question is not whether the tax planning is literally within purview the law, the question is whether it defeats the intention or the purpose of the law, which turns the tax planning into the situation of tax avoidance. And this question of morality is the issue which is being tackled internationally by all the nations.

COME!!! LET'S REGISTER IN RERA
- CA MAYANK SARAF

Introduction

The real estate (Regulation and development) Bill, 2013 was introduced in the parliament in August, 2013. The union cabinet of India in December 2015 approved the bill wit h 20 major amendment based on the examination done by the select committee. The most recent version of this bill was passed in both the houses of parliament in February 2016. The bill became effective on May 1, 2016 as Real estate (Regulation and development) Act, 2016.

The Act overrides the current state legislation of Maharashtra Housing Regulation Act to the extent of repugnancy, as being the central legislation shall uniformly govern the areas as are taken up therein.

Scope: Overview

The act is applicable to the residential as well as commercial areas of real estate. The real estate act makes it mandatory for all commercial and residential real estate Project where the land is over 500 sq. mtrs. Or eight apartments, to register with Real estate regulatory Authority (RERA) for launching project.

Developer will need to disclose names of promoters, project layout, plan of development works, land status, status of statutory approvals, draft of builder buyer agreements, and names and address of real estate agents, contractors, architect and structural engineers to the Regulatory Authority.

Ongoing projects: Ongoing projects that have not received completion certificate in specified time (3 months), developer will have to make public the original sanction plans with the specification and changes made later, total amount collected from allottees, money used, original time for completion and time period within which the developer undertakes to complete the project.

Registration of Real estate agents: Real estate agents who will be dealing with sale or purchase of properties will be required to register under RERA. Such agents will be issued a single registration number for each estate or union territory, which must be quoted by the agent in every sale facilitated by him.

REGISTRATION OF REAL ESTATE PROJECT AND REGISTRATION OF REAL ESTATE AGENTS (as per central act, incorporation Maharashtra rules)

Who is required to make application?

The application is required to be made by <u>every promoter</u>

(i) Who constructs of causes to be constructed an independent building or a building consisting of apartments, or converts and existing building or a part thereof into apartments, for the purpose of selling all or some of the apartments to other person and includes his assignee; or

(ii) Who develops land into a project, for the purpose of selling, whether with or without construction if any structure thereon; or

(iii) Who is development authority or a public body in respect of allottees of;
- (a) Buildings or apartments, constructed by such authority or body on lands owned by them or placed at their disposal by the government; or
- (b) Plots owned by such authority or body,
- (c) For the purpose of selling of the apartments of plots; or

(iv) Who is an state level co-operative housing finance society and primary co-operative housing society which constructs apartments or buildings for its members or in respect of the allottees of such apartments of buildings; or

(v) Any other person who acts himself as a builder, colonizer, contractor, developer, estate developer or by any other name or claim to be acting as the holder of power of attorney from the owner of land on which building or apartments is constructed or plot is developed for sale; or

(vi) Such other person who constructs any building or apartment for sale to general public.

Other Provisions:

Application for registration of Real estate Project:	Form 'A' (Submission in triplicate)
Registration Fee:	Rs 50000 < Area of land proposed to be developed X Rs 10 per sq. mtr. < Rs 10 Lacs
Consequences of non registration:	Prohibition on advertising, marketing, booking, selling or offer to sell etc. <u>If contravened above, punishment will be:</u> Imprisonment for a term which may extend up to 3 years; or Fine that may extend up to further 10 % of estimated cost of real estate project, or with both.

<u>Explanation:</u> The registration of real estate project shall not be required,

(i) For the purpose of any renovation or repair or redevelopment which does not involve marketing, advertisement, selling or new allotment of any apartment, plot or building as the case may be under the real estate project;

(ii) Where only structural repairs of existing buildings are being undertaken by or through any public authority or as per requirement under the law, rules or regulations of the state government or directions of any competent authority.

Note: If the promoter wishes to withdraw his application for registration of the real estate project he may do so before the expiry of 30 days of the submission to the authority. Registration fees will be refunded after making deductions on account of administration charges as specified in regulations.

Registration of Real estate agents

1. Real estate agents cannot facilitate the sale or purchase of or act on behalf of any person to facilitate sale or purchase of any plot, apartment or building as the case may be in a real estate project, without obtaining a registration number.

2. On an application made by real estate agents in form 'G' with the prescribed documents & fees (Rs 10000, in case of individual / Rs. 100000/- in other case), Registration will be granted within 30 days of application in form 'H'. Registration granted under this rule will be valid for 5 years.

3. Every real estate agent, shall be granted a registration number by the authority, which should be quoted by the real estate agent in every sale facilitated by him under this act.

4. Renewal of registration: Application shall be made, at least 60 days prior to expiry of the registration, in form 'J' and accompanied with the same fees as applicable in new registration. New registration will also be valid for another 5 years.

INTENSIVE STUDY COURSE ON GST FOR BEGINNERS

Shri P.K. Agrawal
Joint Commissioner of Sales Tax (Adm), Nagpur

CA Hemant Rajandekar

CA Shailendra Jain

CA Milind Patel

CA Ritesh Mehta

CA Varun Vijaywargi

CA Satish Sarda

CA Saket Bagdia

HALF DAY SEMINAR ON PMLA & BENAMI ACT

Shri Sanjay Bangartale
Dy. Director
Enforcement Directorate

CA. Kailash Jogani

Adv. Shyam Dewani

EVENT CLICKS

Press Meet on GST

Shri A K Pandey
Chief Commissioner Central Excise

Study Circle Meet on Direct Taxes

CA. Naresh Jakhotiya

Seminar on
Real Estate (Regulation and Development) Act, 2016 (RERA)

CA. Vinit Deo, Pune

CA. Prajakta Shetye, Pune

I don't believe you have to be better than everybody else. I believe you have to be better than you ever thought you could be

EVENT CLICKS

Felicitation of Dr. Subramanian Swamy, Former Union Minister and MP Rajya SabhaAt the hands of CA. Sandeep Jotwani, Chairman

GST MIGRATION CAMP
17th to 19th APRIL, 2017