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kcm Insight

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Dear Reader,

We are happy to present **kcm**Insight, comprising of important updates in the M&A space, legislative changes in direct and indirect tax law, corporate & other regulatory laws, as well as recent important decisions on direct and indirect taxes.

We hope that we are able to provide you an insight on various updates and that you will find the same informative and useful.

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Working Capital in Transaction Valuation

Introduction

In transaction valuations, “Net Debt” and “Normalized Working Capital” play a significant role in the assessment of the target and the overall deal structure. During the due diligence phase, the acquirer closely examines the financial performance of the target. These metrics provide valuable insights into the target’s financial health, operational efficiency, and potential risks, allowing the acquirer to make informed decision and effectively negotiate the transaction.

Let us understand some of the most commonly encountered Net Debt and Normalized Working Capital adjustments that are made to the target’s enterprise value to arrive at its equity value in a transaction.

Net Debt

Net Debt is a crucial financial metric used to assess a target’s overall debt burden and its ability to meet its financial obligations. Net Debt is arrived at by subtracting the target’s cash and cash equivalents and liquid investments from its total debt including short-term and long-term, secured and unsecured, and interest accrued thereon. All forms of compulsorily redeemable and non-convertible financial instruments are treated as Net Debt. A high Net Debt relative to the operating earnings (EBITDA) of the target indicates a potential financial risk, which results in a lower equity value for the target.

Net Debt that is reported in the balance sheet of the target often shows a distorted picture as certain debt like items are hidden in the balance sheet masked as working capital items. As such, adjusted Net Debt is widely used by investors, lenders, creditors, and analysts to evaluate a target’s financial health, creditworthiness, and its actual debt servicing capacity. Below are a few common adjustments seen to arrive at the adjusted Net Debt position:

Stretched creditors: When payment to a creditor is not made within the credit period, that liability is a debt-like item or source of funding and not an operational item. Additional funds will be required to service such creditors hence it is added to net debt and removed from reported working capital.

Capital creditors: Capital creditors are related to the payments due for fixed or long-term assets of the target. These are usually group under operational creditors and needs to be adjusted as a part of net debt and removed from reported working capital.

Related party balances: These are balances outstanding in relation to the related party transactions entered and as these payments would generally have favorable credit terms as compared to external non-related creditors/debtors, these are considered as a debt-like item and adjusted from reported working capital.

Provision for long term employee benefits: Provision for employee benefits in relation to gratuity, compensated encashment, pension plans, superannuation, etc. are considered as a long-term liability and a non-operational item in day-to-day business operations, hence it is added to the net debt.

Provision for income tax: Provision for income tax is a non-operating provision as it does not impact the operating earnings (EBITDA) of the target, which is why it is adjusted as a debt like item.

Working Capital in Transaction Valuation

Finance lease obligations: As these liabilities pertain to funding or financing of long-term fixed assets, these are adjusted as net debt for the purposes of transaction valuation.

Advance from customers: As reported cash and bank balances includes the amount received as advance from customers, the same is adjusted back from net cash primarily because this would result in non-cash revenue getting generated going forward.

Capital commitments: Those payments which are planned or committed by the target to be spent to complete an ongoing project, or order placed for fixed assets, or any near-term capex are not reflected in the balance sheet and thus funding would be required in the near future. As such, it is added to the reported net debt of the target.

Deferred tax liability: Target would be required to pay higher tax going forward on account of timing difference on taxation for e.g., on depreciation as per income tax vis-à-vis reported in the books of accounts. Often debated, however, the same may get adjusted as net debt.

Deposits placed as margin: Reported cash and bank balances may include deposits which are placed as margin against bank borrowings or bank guarantees. As these balances are necessary for funding the business and operational activities, these are removed from reported cash balances and considered as a working capital item.

Pre-closing litigation matters: Any liability or provision in relation to any open litigations or claims are considered debt like and adjusted from valuation as net debt.

Exposure from tax or legal due diligence: Any exposure that is probable to lead to a cash outflow on account of any finding from the due diligence exercise needs to be considered as an adjustment to valuation.

Transaction related costs: Costs such as stamp duty, documentation charges, advisor fees, compliance expenses, carve-out expenses, etc. which are to be borne by the target in relation to the transaction are adjusted as net debt.

Normalized Working Capital

Normalized Working Capital is a fundamental financial metric that signifies the liquidity and operational efficiency of a target. Calculated as the difference between a target's operating assets (such as accounts receivable and inventories) and its operating liabilities (including accounts payable and accruals), Normalized Working Capital provides insight into a target's ability to meet its operating obligations.

Assets and liabilities corresponding to the operating earnings (EBITDA) are considered to be forming part of the Normalized Working Capital except where any such items is considered as Net Debt. As such, asset and liabilities not forming part of net cash or net debt, fixed assets, and equity are considered as part of the Normalized Working Capital. It is pertinent to note that debt like items which have been culled out of reported working capital will result in an increase in the Normalized Working Capital of the target.

For the purposes of valuation, the Normalized Working Capital is generally agreed based on

Working Capital in Transaction Valuation

the historical trend and/or cyclicality in the working capital observed during the due diligence exercise to "normalize" the effect of any one-off or non-recurring or non-operational item. Normalized Working Capital is generally expressed as days of revenue based on diligence trend subject to seasonality or cyclicality. Normalized Working Capital is compared with the actual working capital as on the valuation reference date and shortfall or excess is adjusted from the valuation. As the enterprise value is generally agreed on cash/debt free basis, this adjustment is necessitated as sellers would try to reduce the working capital and convert it to net cash which could enhance the valuation. However, the acquirer would have to pump in more cash post-acquisition to finance the working capital gap created by the seller and hence this adjustment becomes extremely critical in negotiating transaction valuation.

Following are some of the common adjustments to arrive at Normalized Working Capital, apart from the ones discussed above in relation to the adjusted Net Debt:

Provision for doubtful debts: Trade receivables which are not received within the normal credit period are adjusted form the reported working capital as provision for bad and doubtful debts subject to balance confirmations or subsequent collections from debtors.

Inventory valuation adjustment: While valuing the inventories, the target may have undervalued or overvalued the inventories by not properly following the valuation norms, for e.g., by improper allocation of overhead costs to inventories.

Non-moving inventories: There are cases wherein the inventories carried in books are too high but may have become obsolete or non-usable due to its age. To normalize the levels of inventories carried in books, appropriate adjustment needs to be made to arrive at the normalized working capital.

Cut-off adjustments: The target may not have completely recorded the transactions in respective period of accrual such as return of goods, reversal of debtors on account of revenue cut-off at period end, inventories in transit, expense accruals, etc. which may lead to misstatement of operating earnings (EBITDA) and thus working capital also gest impacted. Hence such transactions are identified during due diligence, and adjustment is made to the reported working capital.

Income tax refund receivable: This is not an operational item reported in the balance sheet and shows an inflated working capital position. Income tax being an item not impacting the EBITDA is adjusted from reported working capital.

Capital advances: These are advances made towards procurement of fixed assets, and hence do not form a part of the operating working capital of the target.

Working Capital in Transaction Valuation

Conclusion

Net Debt and Normalized Working Capital are vital in determining the final consideration in an M&A transaction. These financial metrics are critical for the purposes of valuation as well as post-acquisition integration. These adjustments ensure that parties to a transaction have a fair understanding and agreement of the target's financial position to help conclude the transaction. As these adjustments directly impact the transaction consideration, extensive negotiations take place in relation to these matters while finalizing the definitive agreements to avoid any ambiguity while closing the transaction.

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Important Rulings

Depreciation on UPS, used for computer, allowable at 60%

PCIT v. Nestle India Limited, ITA 303/2023, Delhi HC

The Taxpayer, in the return of income filed for the year under consideration, claimed depreciation on UPS equipment at the rate of 60%. The AO restricted the claim of depreciation from 60% to 15%.

An appeal was preferred before CIT(A) wherein the matter was decided in favor of the Taxpayer. ITAT also upheld the view of CIT(A). The matter was reached before the High Court.

Revenue contended that the UPS equipment could be used for purposes other than running a computer and, therefore, is not an integral part of the computer, unlike the computer peripherals, therefore, the judicial precedence relied by the Taxpayer would not be applicable.

HC noted that there is nothing on record to show that UPS was used for any other purposes other than running a computer. Therefore, depreciation should be allowed on UPS @ 60% in the facts of the case.

It may also be noted that HC placed a caveat, in the order, that this decision does not intend to suggest that any and every piece of equipment which, acts as a UPS, say for an industrial unit, be eligible for depreciation at the rate of 60%, as against the rate provided in the residuary entry which is 15%. It is imperative to note that the facts of this case, indicating that UPS was only used for running a computer, played pivotal role in granting depreciation at rate of 60% to the Taxpayer.

100% deduction is allowed u/s 80IC from initial AY, post substantial expansion, despite of full deduction is claimed in first 5 years after commencement

Tejpal Chaudhary v. CIT, SLP No. 14552/2019, SC

The Taxpayer filed return of income, for the year under consideration, wherein, deduction u/s 80IC was claimed in respect of 100% of profits and gains of the eligible undertaking on account of substantial expansion undertaken during the said year. The AO restricted claim u/s 80IC of the ITA to the extent of 25% on the ground that deduction at 100% of profits is available for only five assessment years including the initial assessment year and thereafter deduction to the extent of 25% would be available for the remaining five assessment years.

The Taxpayer had claimed deduction in respect of 100% of profits for first five years, thereafter, had substantial expansion and again claimed 100% deduction of profits in the year under consideration based on the definition of initial assessment year u/s 80IC of the ITA.

CIT(A), ITAT and HC rejected the appeal preferred by the Taxpayer relying on the decision of Apex Court in the case of Commissioner of Income Tax vs. M/s Classic Binding Industries, Civil Appeal No(s) 7208 of 2018.

Matter reached before the SC. SC reversed the decision of HC holding that Apex Court in the case of PCIT v Aarham Softronics 11 SCC 551(2020) has held that the judgement in Classic Binding Industries omitted to take note of the definition of "Initial Assessment Year" contained in section 80-IC and instead concluded based on the definition contained in section 80IB of the ITA, which was not applicable to section 80IC of the ITA. The definitions of

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'initial assessment year' in the two sections, viz. Sections 80-IB and 80-IC are materially different. Thus, the appeal of the Taxpayer was allowed, and it was held that the Taxpayer is entitled to exemption u/s 80IC to the extent of 100%.

It may be noted that as per definition of 'initial assessment year' contained in clause (v) of sub-section (8) of section 80-IC, there can be 'initial assessment year', relevant to previous year, in any of the following contingencies: (i) the previous year in which the undertaking or the enterprise begins to manufacture or produce article or things; or (ii) commences operation; or (iii) completes substantial expansion. Apex Court, in case of Classic Binding, took the view that once 'initial assessment year' starts on fulfilling the conditions laid down in sub-section (2) of section 80-IC, there cannot be another 'initial assessment year' for the purposes of section 80-IC within the aforesaid period of 10 years. However, in the decision in the case of Aarham Softronics, it was held that based on the scheme of the ITA u/s 80IC, the definition of 'initial assessment year' contained in clause (v) of sub-section (8) of section 80-IC can lead to a situation where there can be more than one 'initial assessment year' within the said period of 10 years.

Deduction u/s 80G allowable in respect of CSR expenditure subject to satisfaction of conditions therein

Synergia Lifesciences Pvt. Ltd. v. DCIT, ITA no.938/Mum/2023, Mumbai ITAT

The Taxpayer is engaged in the business of manufacturing, selling, and conducting research and development activities in fermentation and life science products using biotechnology. The Taxpayer had incurred expenditure, on account of donation given, in accordance with the Corporate Social Responsibility guidelines issued under the Companies Act, 2013. The Taxpayer disallowed the expenditure incurred u/s 37(1) of the ITA and claimed deduction u/s 80G of the ITA in respect of such donation.

The AO contended that the Taxpayer is not eligible for claiming deduction u/s 80G of the ITA in respect of expenditure incurred in accordance with section 135 of Companies Act, 2013, as the same has not been done voluntarily by the Taxpayer. AO held that there should be element of charity and voluntary for being considered as a donation for the purpose of claiming deduction u/s 80G of the act, which was missing in the present case.

CIT(A) dismissed the appeal filed by the Taxpayer.

ITAT relied on the decision of Coordinate Bench in the case of Allegis Services (India) Private Ltd. V/s ACIT, in ITA No. 1693/Bang/2019, wherein it was held that benefit accruing to assessee under Chapter VIA cannot be denied to assessee, subject to fulfillment of necessary conditions therein. If assessee is denied this benefit, merely because such payment forms part of CSR, it would lead to double disallowance, which is not the intention of Legislature.

In view of the aforesaid decision, ITAT remitted the issue to the file of the AO to verify the conditions necessary for claiming deduction under the said section and allowed the appeal in favor of the Taxpayer for statistical purposes.

Interest on CCDs allowable as revenue expenditure

DCIT v. Religare Finvest Ltd., ITA no.4796/Del/2017 and Ors, Delhi ITAT

During the year under consideration, the Taxpayer had issued 10.9% Compulsory Convertible Debentures ('CCDs') to its holding company. These instruments were to be converted into equity after a span of 5 years. The Taxpayer claimed deduction in respect of interest expenditure paid on these CCDs in the return of income.

AO disallowed the interest expenditure claimed by the Taxpayer by holding that interest paid on CCDs is akin to dividend as the intent for issuance of CCDs is to issue equity shares. AO placed reliance upon the RBI circular no. 74 dated June 8, 2007 under the FDI policy, wherein it has been laid down that CCDs are to be considered as equity.

CIT(A) held the matter in favour of the Taxpayer for three AYs in question and in favour of revenue for the remaining AY.

Before the Tribunal, The Taxpayer argued that the two instruments viz. debenture and shares are mutually exclusive, with separate rights and obligations of both the issuer company and the subscriber. For instance, instrument of debenture is evidence of existence of debt with the issuing company, and shares is not in nature of debt, but form part of permanent capital of the company, entitling the holder to certain preferential rights like voting rights, dividend, etc.

Further, in view of CCDs subscription agreement, there is interest burden on the issuing company and there are no voting rights, so CCDs cannot be equated with shares until conversion.

The Tribunal, relying on various judicial precedence, held that the expenses incurred on issue of debentures, whether convertible or not, are deductible as business expenditure u/s 37(1) of the ITA since when the debenture is issued, it is a debt, whether it is convertible or not, does not change the nature of debenture. SLP preferred by Department against the order of Rajasthan HC in the case of CIT v Secure Meters Ltd 321 ITR 661 is dismissed by the SC.

As against the reliance of Department on the RBI circular under the FDI policy, ITAT remarked that the Circular merely deems CCDs as part of equity/capital for the purpose of keeping check on measures used to circumvent the framework for regulating debt flow in the country.

In view of the above, ITAT held that interest paid on CCDs is an allowable revenue expenditure u/s 36(1)(iii) as CCDs are in the nature of borrowed funds and continue to be debt till their conversion into equity shares.

Write-off of irrecoverable intra-group advance allowable u/s 28

Mahindra and Mahindra Ltd. v CIT, ITA no. 626 of 2002, Bombay HC

The Taxpayer is a public limited company engaged in manufacturing jeeps, tractors, implements and other products. The Taxpayer was the promoter of MMC holding more than 27% of the equity capital of MMC. MMC incurred huge losses due to severe recession in industry and thus a rehabilitation scheme was worked out by IDBI for their revival. An integral part of the scheme was that the Taxpayer was required to contribute directly to funding of MMC and

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provide guarantee in respect of the assistance disbursed by IDBI. The rehabilitation program failed, and the subsidiary was referred to the BIFR who concluded that the subsidiary shall be wound up.

In the year under consideration, the Taxpayer had: (a) incurred expenditure towards salary of staff and officers of MMC; (b) (i) an amount was due from MMC, which was written off; (ii) advances against purchases of machines from MMC, and those machines were not received (iii) unpaid interest due from MMC on ICDs (iv) rehabilitation assistance given to MMC; (v) there were liabilities against guarantees given by the Taxpayer to IDBI in respect of IDBI loans to MMC, which totaled to Rs.622.01 lakhs, which was claimed as deduction u/s 28 of the ITA in return of income. The Taxpayer claimed that such expenditure was incurred in view of preserving the goodwill of the group and due to business acumen and commercial expediency of the Taxpayer.

AO disallowed aforesaid claim by contending that Taxpayer was in no way obliged to incur such expenses and provide the required assistance when the other majority shareholders did not contribute anything and thus the same are not related to the business of the Taxpayer. Further, the name Machinery Manufacturers Corporation Ltd. did not contain any reference to Mahindra and Mahindra or any Mahindra Company. CIT(A) and ITAT upheld the order of the AO.

ITAT was of the opinion that under no principle of accountancy or law can a deduction be allowed for the expenditure incurred by any the Taxpayer to meet the liabilities of another company and for the debts written off in the book since the same were not trade debts, but the loans advanced to a subsidiary and written off in the books.

HC noted that the expenditure was wholly incurred for the purpose of commercial expediency because MMC was a group company of the Taxpayer and the Taxpayer was, as could be seen from the orders passed by BIFR, keen in the preservation of MMC and to keep it as a going concern. If there was no commercial expediency, there was no reason for the Taxpayer to incur these amounts or participate in the rehabilitation scheme of MMC. It is certainly not necessary for the name of Mahindra and Mahindra to be used in the name of MMC to prove it was a group company. HC relied upon the decision in the case of Delhi Safe Deposit 1982 (133) ITR 756 wherein the SC held that the expenditure incurred on the preservation of a profit earning asset of a business is always a deductible expenditure.

It was further held that once the assessee records the amounts as business loss/deductions in his books of account, that would prima facie establish that it was not recoverable loss unless the Assessing Officer for good reasons holds otherwise. A sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitate the carrying on the business, may yet be expended wholly and exclusively for the the purposes of the trade.

In view of the above, HC held that these expenditure/debts should be treated as having been incurred for the purpose of business and eligible for deduction as business expenditure/loss u/s 28 of the ITA.

Important Updates

Extension of time limit for filing of certain TDS/TCS returns for Q1 of FY 2023-24

Circular No. 9/2023 [F. No. 370149/109/2023-TPL] dated June 28, 2023

CBDT has extended the time limit for submission of TDS/TCS statements for the first quarter of FY 2023-24 as below:

- Form 26Q/27Q for first quarter, which is to be filed by July 31, 2023, may be furnished on or before September 30, 2023
- Form 27EQ for first quarter, which is to be filed by July 15, 2023, may be furnished on or before September 30, 2023

Implementation of changes relating to TCS on Liberalized Remittance Scheme (LRS) & on purchase of overseas tour package

Circular no. 10 of 2023 [F. No. 370142/23/2023-TPL] dated June 30, 2023

Section 206C(1G) of the ITA was amended vide the Finance Act, 2023 to increase rate of TCS from 5% to 20% for remittance under LRS as well as for purchase of overseas tour package and threshold of Rs. 7 lakhs for triggering TCS on LRS was removed. Further, FEMA Rules removed differential treatment for credit cards vis a vis other mode of drawl of foreign exchange under LRS.

The implementation of amended provision caused many practical difficulties and therefore, this Circular is issued by CBDT directing as under:

- The threshold limit of Rs. 7 lakh per financial year per individual is restored for TCS on all categories of LRS payments, through all modes of payment, regardless of their purpose. Beyond Rs. 7 lakhs, TCS shall be at rate of
  i. 0.5% (if remittance for education is financed by loan taken from financial institutions)
  ii. 5% (remittance for education/ medical treatment)
  iii. 20% (For others)

  Purchase of overseas tour package shall continue to apply rate of 5% for TCS for the first Rs. 7 lakh per individual pa. and 20% rate will apply for the expenditure above the limit.
- Increased TCS rates shall apply from October 1, 2023.
- No TCS shall be applicable on expenditure through international credit card while being overseas, till further order.

Apart from the above, various FAQs have been issued to address difficulties, which may come, in giving effect to the aforesaid provisions in the circular, issued.

Amendments made in Rules and Forms to incorporate amendments brought vide Finance Act 2023

Notification No. 45 / 2023 / F. No. 370142 / 18 / 2023 - TPL dated June 23, 2023

The government have now made consequential amendments in Rule 2C, 11AA and 17A of the Income-tax Rules and Forms 10A & 10AB to incorporate the amendments made by Finance Act 2023 related to charitable/religious trusts or institutions registered/approved under Sections 10(23C), 80G and 12A of the Income Tax Act, 1961.

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Amendment in Rule 11UAC with respect to relocation of offshore funds to IFSC

Notification No. 51 / 2023 / F. No. 370142 / 22 / 2023 - TPL dated July 18, 2023

CBDT has amended Rule 11UAC to provide that provisions of section 56(2)(x) shall not apply to any movable property being shares, units or interest in resultant fund as defined u/s 47(viiad), received by Fund Management Entity of the resultant fund in lieu of shares, units or interest held by the investment manager entity in original fund as defined u/s 47(viiad), pursuant to relocation by Investment Management Entity, subject to below conditions:

(i) not less than 90% of shares or units or interest in the fund management entity of the resultant fund are held by the same entity(ies) or person(s) in the same proportion as held by them in the investment manager entity of the original fund; and

(ii) not less than 90% of the aggregate of shares or units or interest in the investment manager entity of the original fund was held by such entity(ies) or person(s).

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Indian Rulings

Receipts from offshore supply and services not taxable in India

Bombardier Transportation GmbH [ITA No.1390/Del/2015 – Order dated 14 July 2023]

The taxpayer is a non-resident engaged in the business of integration & manufacturing of rolling stocks and railway applications. It entered into a contract with Indian customer wherein its Indian subsidiary was a consortium partner to the contract. As per the contract, the offshore portion of the contract was to be undertaken by the taxpayer and the onshore portion such as indigenous manufacturing, testing, commissioning, training etc. was undertaken by the Indian subsidiary.

It was contended by the revenue that the taxpayer carried out the activities through its Project Office and subsidiary's premises in India and thus it constituted Fixed Place PE in India under the treaty. Accordingly, it was contended that profits attributable to such PE towards offshore supplies should be taxable in India. The Hon'ble Tribunal held that although a single contract was entered by the taxpayer & its subsidiary with the customer in India, however, the contract was a divisible contract considering the following relevant factors:

- Revenue failed to demonstrate that the taxpayer has carried out offshore activities from Fixed Place PE. No records with revenue demonstrating that the taxpayer has utilized the subsidiary's premise & hence disposal test for Fixed Place PE was not satisfied.
- The taxpayer and the subsidiary have separately raised invoices for the offshore and onshore supply & services and payments were made by the customer separately.
- Consortium contract with the customer refers to the MoU entered between the taxpayer & its subsidiary clearly defining the roles & responsibilities of both the parties.
- Cost attached to scope of work assigned to the taxpayer & its subsidiary were put under different cost centers in the contract with customer.
- Transaction between the taxpayer & its subsidiary was held to be at ALP as per the Transfer Pricing assessment.
- Employee's visit to India was only with respect to supervisory work to ensure timely delivery of train sets.

On the basis of above factors, it was held that the receipts from offshore supply cannot be taxed in India as title over the goods were transferred outside India. While in past, there are many rulings stating that income from offshore supplies / services is not taxable in India, yet the Revenue tries to bring the offshore supplies in the tax bracket in India by differentiating the facts of each case. Accordingly, the above factors (though not exclusive) may play a vital role in determining the taxability of the offshore supplies in India.

Independent projects not to be aggregated for carrying out Duration Test for examining PE

Planetcast International Pte. Ltd [TS-389-ITAT-2023(DEL) – Order dated 14 July 2023]

The taxpayer, a Singapore resident, entered into two separate contracts with an Indian customer for supply of equipment including installation and thereafter it sub-contracted the work to another non-resident entity. The Revenue contended that the taxpayer formed Installation PE in India and thus profit from supply of equipment and installation services as may be attributable to the PE is taxable in India.

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The Hon'ble Tribunal noted that in relation to the transaction of supply of equipment, the title over the goods passed outside India and installation activities were carried out post such supply, hence receipt from such supply of equipment cannot be taxed in India. In the context of Installation PE, the Tribunal observed that the installation / commissioning activities could not have commenced unless the equipment were delivered at the customer's location. Hence, the date of commencement of Installation PE cannot be considered as date of raising the first invoice, the date of commencement of Installation PE to be considered when the actual installation / commissioning activities started. Accordingly, it was held that the requirement of 183 days for satisfying the requirement of Installation PE as per India-Singapore DTAA does not get fulfilled.

Additionally, it was also held by the Tribunal that India-Singapore DTAA does not require the taxpayers to aggregate the number of days of similar projects carried out by the taxpayer for computing the duration of the Installation PE in absence of specific language in the DTAA as used in other DTAAs such as India-US, India-Italy etc. Accordingly, since both the projects were independent, each project is to be seen on separate basis.

The above ruling is in line with the OECD commentary wherein in the context of Installation PE, the OECD states that a site exists from the date on which the contractor begins his work in the country where the construction / installation is to be established and such site should be at disposal of the contractor during such period. Further, OECD also states that the twelve-month test applies to each individual project and in determining how long the project has existed, no account should be taken of the time spent on other projects totally unconnected with it. However, the question whether the projects are connected or not is itself a litigative issue and needs to be evaluated on facts of the case.

Delhi HC allows deemed FTC pursuant to Tax Sparing provisions

Polyplex Corporation Ltd. [ITA No. 571/2019, 573/2019 to 575/2019 – Order dated 18 July 2023]

Taxpayer, an Indian company received dividend income from its wholly owned subsidiary in Thailand. Dividends earned by foreign company from Thailand were liable to tax at 10% in Thailand as per its domestic laws. However, Investment Promotion Act ('IP Act') of Thailand granted exemption from income tax on dividends from specific companies. Accordingly, dividends derived by the taxpayer were exempt in Thailand, although it claimed deemed FTC on such dividends in India.

Tax authorities contended that such claim of FTC is unacceptable on the ground that Article 23(2) of India-Thailand DTAA only allows relief against income which have been "subjected to tax" in both the countries. Further, it was contended that IP Act does not grant exemption to foreign companies and hence, the issue is not covered by Tax Sparing provisions of DTAA. Consequently, taxpayer's claim for deemed FTC was denied. On the other hand, taxpayer contended that Thai tax payable under IP Act should be allowed as deemed FTC by virtue of provisions of Article 23(3).

Hon'ble Delhi HC referred to the language of Article 23 as well as IP Act and provisions of Thai

Revenue Code. It observed that the term "Thai tax payable" in Para 2 to Article 23 has been specifically defined to include taxes exempted as per IP Act as per Para 3 to Article 23, hence concluded that provisions of DTAA should be read in entirety and not in isolation. Further, it referred to certificate issued under IP Act to hold that dividends earned by taxpayer have been granted specific exemptions from tax under such a certificate. Resultantly, Hon'ble HC upheld the view that deemed FTC is to be allowed in case of Taxpayer.

Tax sparing credit in context of DTAAs refers to a method to give benefit in residence country of not only taxes actually paid in foreign country but also taxes which would have been paid but exempted in source country due to certain tax incentives. The concept of Tax Sparing has been embedded in several Indian DTAAs such as with France, Jordan, Oman and Philippines as a mechanism to incentivize investments for economic development. Although, such provisions have been intentionally agreed upon to incentivize taxpayers, however it would be important to also take note of the provisions of MLI where the Preamble provides that treaties only intend to eliminate double taxation without creating any opportunities for double non-taxation. Hence, it would be interesting to analyze how the provisions of MLI will impact tax sparing credit provisions.

No separate notification required to invoke MFN clause and DTAA rates are all-inclusive

TDK India Private Limited [ITA No. 393 to 399/Kol/2023 – Order dated 12 July 2023]

The taxpayer was a tax resident of India. It was engaged in manufacture and supply of capacitors and soft ferrite cores. It had paid procurement, controlling, logistic coordination, quality management, HR related fees to its Spain based group entity. It had deducted TDS at 10% under provisions of Article 13 of India-Spain DTAA read with protocol to said DTAA.

The taxpayer believed that as per Article 13 read with protocol of DTAA which provides for MFN clause, the rate of tax applicable to payment made to Spain based vendor was 10% considering India-Portugal and India-Sweden DTAAs as comparatives.

CIT(A) upheld the AO's order to charge interest under section 201(1A) of the ITA due to short deduction of TDS. It held that taxpayer's Spain based vendor was not entitled to get the benefit of Protocol to DTAA as the same was not notified in official gazette as per section 90(1) of ITA as required by CBDT circular No. 3/2022 dated 03 February 2022.

The core issue for consideration before the ITAT was that whether the requirement of a separate notification to implement terms of DTAA under CBDT Circular dated 03 February 2022 was applicable in taxpayer's case and whether surcharge and cess were applicable on rates provided under DTAA.

ITAT ruled in favor of the taxpayer. It relied on the ruling given by Kolkata ITAT bench in case of ITC Ltd holding that protocol is an integral and indispensable part of DTAA and the benefit of lower rate as prescribed in the protocol for fees for technical services under the relevant tax Treaty is not dependent on any further unilateral action or issuance of notification by the respective Governments. Accordingly, no separate notification is required to be issued in order to make a protocol applicable. Further, it relied on Kolkata Tribunal's ruling in case of BOC

Group Ltd holding that surcharge and cess are inclusive parts of tax rates provided under DTAA as per the definition of tax provided under Article 2 of DTAA.

The ruling is clarificatory in nature and emphasizes the settled law that rates provided under DTAA are all-inclusive and protocol in relation to MFN is an integral and inseparable part of DTAA. However, neither revenue nor the Tribunal considered/discussed whether the Spain based group entity had a PE in India. Likewise, while drawing inference from India-Portugal DTAA, the question whether MFN clause under India-Spain DTAA would include the 'make available' condition and hence, no tax was not discussed.

Reimbursement of salary of employees by Indian Subsidiary to UK Parent not taxable as FTS

Serco India Pvt. Ltd [ITA No. 1432/Del/2016 – Order dated 27 June 2023]

The taxpayer, an Indian Company, had requested its parent company, Serco UK, to provide certain employees. Upon request from Serco India, Serco UK released three employees, who were then given appointment letters and were employed by Serco India. For the purpose of administrative and employee's convenience, part of their salary was provided to the employees in their home country by Serco UK, which were reimbursed by Serco India after deduction of applicable taxes on salaries under Section 192 of the Act. DRP enhanced income of Serco India by disallowing salaries reimbursed to Serco UK on the grounds that no tax was withheld u/s 195 of the Act holding that the same were in the nature of FTS.

The Delhi bench of ITAT took note of the appointment letters provided to the employees and Reimbursement Agreement entered into by Serco India and observed the following:

- Serco UK had released the employees from work and was not responsible for or bound by any act / omission by the employees
- Taxpayer was the sole and exclusive legal and economic employer
- Serco UK was not having lien on the employees
- Employees were to work full time, under exclusive control, direction and supervision of Serco India during the period of employment with the taxpayer
- The obligation to pay salary was on the Taxpayer, who was supposed to inform Serco UK the amount of foreign currency salary that was to be paid to the employees on its behalf
- Taxpayer had right to terminate the employment of the said employees and Serco UK had no obligation to replace any of the employees terminated by Serco India
- Employees had no legal recourse against Serco UK for any conflict arising in relation to their employment with Serco India

Taking into consideration the above facts, the Delhi bench of ITAT concluded that the Taxpayer was the sole legal and economic employer of the employees, and that the salary paid to them was chargeable to tax as salary in the hands of the employees. The decision of SC in the case of Centrica India Offshore Pvt. Ltd. holding reimbursement of salaries of seconded

Important Rulings

employees as FTS was distinguished based on the facts of the case mentioned above. Further, referring to the SC ruling in Northern Operating Systems in context of applicability of service tax on reimbursement of salaries of seconded employees, the ITAT held that the rational of decision of a case from one enactment cannot be applied to an entirely different legislation, especially when the language and purpose of the enactment are different. The ITAT thus concluded that the SC rulings in Centrica and Northern Operating Systems were not applicable to the instant case.

The ITAT also noted that there was no agreement or document to prove that Serco UK provided any technical services to the Taxpayer. The ITAT held that once the employees had offered such salary amount as income by filling their tax returns in India, treating the salary amount as "FTS" in the hands of Serco UK, would amount to double taxation.

Relying on the decision of Hon'ble Karnataka HC in the case of Flipkart Internet Private Limited and Bangalore ITAT in the case of AON Specialist Services it was held that reimbursement of salary expenses to Serco UK was salaries and once tax was withheld u/s 192 of the Act, the same was not liable to tax again as FTS. It may be mentioned that the SC decision in the case of Centrica was distinguished in the present case based on robust documentation and presentation of factual distinction.

Foreign Rulings

Bulgarian Apex Court interprets beneficial ownership based on control, assets, and employees

CBS International Netherlands BV

Taxpayer was resident of the Netherlands and a wholly owned subsidiary of another Netherlands Corporation, which was ultimately owned by a company incorporated in the USA. The taxpayer entered into a television license contract with Fox Networks Group Bulgaria Ltd. ('Fox Bulgaria') and received royalties under the said contract for granting a television license to distribute television programs.

Taxpayer claimed that royalty income was not taxable as per Article 12 of Bulgaria-Netherlands DTAA, read with Article VIII of the appended protocol, which provided exclusive taxing rights to the residence State. Against the said claim, the tax authorities contended that taxpayer is not the beneficial owner as it merely acts as an intermediary between the end customers and the US Company (i.e., owner of license) and thus not entitled to treaty benefit.

The SAC of Bulgaria observed that the income is derived from the activity of granting rights under television license contracts. Tax authorities neither denied the fact that taxpayer had created such rights through which the income arose, nor did the taxpayer's right to grant the use of the copyright objects is under question. Hence, taxpayer is not a conduit company. Further, control on taxpayer is exercised by another Dutch company which is covered by Bulgaria-Netherlands DTAA and there was nothing to prove that control on the taxpayer is exercised by US company. Taxpayer had assets, capital, and its specialized personnel and the taxpayer's employees, offices, and profits were increasing year-on-year. The existence of control over the use of the rights is indicated by the contracts, which provide for penalties for non-performance and Fox Bulgaria's obligation to submit monthly reports. In light of the above discussion, the Court held that taxpayer is the beneficial owner of the royalty income, and thus its income was not taxable in Bulgaria as per Article 12 of the Bulgaria-Netherlands DTAA.

The concept of "Beneficial Ownership" has always been a point of controversy for the fact that it has not been defined in DTAAs resulting into different interpretations by courts and tax administrations across the globe. As such the concept was introduced to curb multinational corporations to enter into complex contracts / structured arrangements for treaty shopping and avoiding taxability. Accordingly, while analyzing such provisions, tax authorities generally adopt "substance over form" approach and have emphasized on commercial rationale, control or dominion etc.

Interplay between DTAA and domestic tax laws while determining tax residential status

GE Financial Investments [Case No. UT/2021/000165 - Order dated 29 June 2023]

The taxpayer was a company incorporated in UK. It held 99% share in the USA based group entity ('a limited partnership' or 'LP') while the balance 1% share was held by another group company based in the USA. As per the USA federal tax laws, the taxpayer was treated as a US domestic entity for tax purposes ('a US tax resident') since it was a stapled entity. A stapled entity signifies two or more entities with stapled interests, i.e., by reason of form of ownership, restrictions on transfer, or other terms / conditions, in connection with the transfer of one of such interests the other such interests are also transferred or required to be transferred. Accordingly, taxpayer had paid US federal Income-tax and claimed FTC in UK. However, UK's first appellate authority rejected the claim by holding that even though taxpayer was liable to federal tax in the US as a US tax resident, it was not a resident in the US for treaty purposes under UK-US DTAA.

The issue for consideration before the second appellate authority ('Tribunal') was whether taxpayer was a resident of US under Article 4 of DTAA and if not, whether it carried on business in the USA through a PE under Article 7 of DTAA.

The Tribunal held that taxpayer was a tax resident of the US for the purposes of DTAA. It observed that even though the provisions of the UK-US DTAA depart from the OECD model in including a reference to citizenship and place of incorporation as per the OECD commentary-residence takes its stand 'entirely' on the domestic law of each contracting state. It further relied on Canadian Supreme Court decisions in Crown Forest and Alta Energy, both of which had established that the criteria in Article 4(1) of the OECD convention is 'full' taxation. It noted that residency is attributed to the territory which has 'full taxing rights' and accordingly, a company treated as a resident under domestic law and taxed in full could not possibly be not-resident under the DTAA.

The Tribunal further held that the taxpayer did not carry on business in the USA through a PE under Article 7 of the DTAA. In this regard, it discussed various case law and observed the following principles for establishing a PE under the DTAA:

- Any gainful use to which a company puts any of its assets prima facie amounts to the carrying on of a business. Cases where this is not so likely to be the exceptions rather than the norm;

- However, not every isolated act of a kind that is authorized by a company's memorandum if done by a company necessarily constitutes the carrying on of a business by it; and
- The carrying on of business usually calls for some activity on the part of the person carrying it on, though, depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between.

It was noted that although taxpayer's objects included making loans, the objects were much wider. What it actually did was to become a limited partner in the USA LP whose objects includes, holding assets, and engaging in lawful activities. Here the Tribunal agreed with lower appellate authority's remark that the taxpayer was a passive investor in the US LP with a general partner who directed activities with limited understanding of the purpose behind those activities.

While the ruling brings clarity on the residential status under UK-US DTAA, there was no discussion on applicability of stapled entity rule to the taxpayer. Further, the ruling also creates a room for subjectivity in deciding which activity should be considered a business activity even though it may be authenticated by its Memorandum of Association.

License fees for use of trademark not inextricably linked to purchase of goods, held taxable as royalties

Cosmetics sp. zo.o. [II FSK 2034/20 – Order dated 07 March 2023]

Taxpayer was a company incorporated in Poland and was engaged in distribution of cosmetics purchased from Swiss PE of a Luxembourg Company. Distribution agreement entered into between Taxpayer and Swiss PE contained a provision that purchase price of the goods would include a 3% markup as remuneration for use of trademarks for promotion, advertisement and sale of goods by the Polish Taxpayer. The Taxpayer contended that the right to use trademark was ancillary and incidental to the main activity of distribution of goods and that the remuneration for use of trademark was inextricably linked and incidental to purchase of goods from the Swiss PE.

The Tax Authorities were of the view that the fee for right to use trademark was neither an incidental element of the purchase consideration, nor was it insignificant or negligible. Tax Authorities considered fees for trademark included in the purchase price of the goods as a separate element of the agreement, taxable as Royalties under Poland-Swiss DTAA and subject to withholding tax in Poland.

The SAC of Poland held that where, elements of transactions relating to supply of goods are inseparably linked making it impossible to distinguish the 'main item' and the 'incidental element' within the supply, it could be unreasonable to separate them for tax purpose. However, in the present case, the SAC held that the transactions (purchase of goods and sub-licensing of the right to use a trademark) were economically and functionally separable and it was thus necessary to separate these elements and apply the taxation method appropriate for each of them.

The SAC held that the fact that the rights were limited to use of trademark for the purpose of activities supporting the process of distribution

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of the goods, were redundant. The SAC held that merely because the rights were so limited, a contractual provision covering the grant of a paid license for the use of trademarks could not be considered as inextricably linked to purchase of goods. Based on the above considerations, the SAC concluded that the fee paid for the use of the trademark, included in the purchase price of the cosmetic products, was taxable as royalty under Article 12(3) of the Poland-Swiss DTAA and that the Taxpayer was required to withhold tax on the same. The decision emphasizes on importance of factual and contractual understanding between the Parties for determining the nature of consideration over the nomenclature used in carrying out the transaction.

Indian Update

CBDT amends Rules relating to income from offshore derivative instruments and income of units in IFSC

Income arising to non-residents from transfer of offshore derivate instruments is exempt u/s 10(4E) of the Act. Finance Act 2023 amended Section 10(4E) to also exempt distributions from offshore derivative instruments to non-residents even if there were no transfers. Corresponding amendments have now been introduced to Rule 21AK in this regard.

With respect to funds registered under International Financial Services Centers Authority (Fund Management) Regulations, 2022, corresponding amendments have been made to Form 10CCF for IFSC units claiming deductions u/s 80LA, to Form 64D (Statement for furnishing details of income of fund u/s 115UB) and to Rule 114AAB for non-applicability of obtaining PAN to unitholders of such specified funds.

Intimation by NRIs / OCIs with inoperative PAN

Non-residents and foreign citizens have been exempted from mandatory linking of Aadhar and PAN. Despite the said exemption, PAN of NRIs / OCIs have been designated as inoperative in certain cases. In this regard, Income tax Department has clarified that residential status of individuals have been mapped based on Income Tax Returns filed for past 3 assessment years or based on intimation provided by such Taxpayers to Jurisdictional Assessing Officers ('JAO'). Where residential status could not be mapped based on the same, PANs not linked with Aadhar have been designated as inoperative. The Tax Department has thus requested NRIs / OCIs to inform their respective JAOs about their residential status along with supporting documents to update the PAN database.

It is important to note that an inoperative PAN is different from an inactive PAN. Even if the PAN becomes inoperative, individuals can still file their Income Tax Returns. However, there are consequences for inoperative PANs, such as pending refunds and interest on refunds not being issued, and tax withholding at a higher rate in some cases.

Important Updates

Foreign update

Updates on OECD BEPS 2.0

The month of July witnessed manifold developments on BEPS 2.0 Project. The OECD-G20-Inclusive Framework members met in Paris between 10 to 12th July, followed by a meeting on 17 July 2023 at Gandhinagar, India. Outcome Statement on various ongoing works on Pillar One and Two of BEPS 2.0 was agreed on 11th July.

Outcome Statement agreed to release Multilateral Convention on Amount A of Pillar One for allocation of taxing rights to Market Jurisdictions, for signing in second half of 2023 and confirmed that the same is proposed to be effective from 2025. Public Consultation Document was released inviting inputs until 1st September, on Amount B under Pillar One relating to simplification of transfer pricing rules for baseline marketing and distribution activities.

Model provisions along-with commentary on STTR have been introduced. STTR under Pillar Two proposes to enable Source jurisdiction to withhold taxes at higher rate where tax in residence jurisdiction is less than 9%. Outcome Statement announced that MLI for implementation of STTR will be open for signature from 02 October 2023.

Inclusive Framework has also issued a package of documents consisting of the GloBE Information Return and further administrative guidance including detailed guidance on currency conversion, substance-based income exclusion, treatment of tax credits, etc. The package sets two new safe harbours to GloBE rules – (i) a permanent safe harbour for jurisdictions that introduce a QDMTT, whereby, Top up Tax of jurisdictions that have introduced QDMTT would be considered as Zero and (ii) a transitional UTPR Safe Harbour, which provides that Top Up Tax for UPE Jurisdiction for the purpose of application of UTPR will be considered as zero, for fiscal years commencing on or before end of 2025.

Kenya's new tax return template requires disclosure of additional details of MNE's intra-group transactions

With a view to assess transfer pricing risks and to address BEPS concerns, the new tax return template issued in Kenya seeks to gather more data on related party transactions vis-à-vis parent entity. Taxpayers would need to disclose more details to Kenyan Revenue Authorities in respect of tax-deductible intra-group expenses, financial performance of the local entity in comparison to the parent entity, details of amounts due to / due from related parties, etc. in their tax returns. Taxpayers would be required to ensure that the details relating to inter-company transactions in transfer pricing documentations and the income tax returns are aligned.

Important Updates

Switzerland proposes to allow carry forward and set off of losses for an extended period of up to 10 years

Currently, carry forward and set off losses is permissible in Switzerland for up to 7 years. Swiss Parliament is considering extension of loss carry forward period from 7 to 10 years for the losses incurred in or after 2020, to provide relief to companies adversely affected by COVID 19 Pandemic. Proposed amendment is currently open for consultation until 19th October 2023 and is proposed to be introduced at Federal as well as cantonal and municipal levels in Switzerland.

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Tax office's claim of deemed taxable transfer of functions, assets, and risks (FAR) leading to change in business model upheld by Israel District Court

[Medtronic Ventor Technologies Ltd vs Kfar Saba Assessing Office (2023)]

A very interesting judgement issued by the Israel District Court which accepted the tax office's views and arguments taking into cognizance three District Court decisions from recent years on post-acquisition business restructuring and transfer pricing changes – Gteko, Broadcom and Medingo. The Medtronic ruling, the most recent link in the chain of FAR court rulings, provides additional insights around the circumstances under which a transaction may be viewed as a taxable sale of FAR.

The appellant, an Israeli private company established in 2004, was engaged in developing an aortic valve and catheter. In 2008, a US company acquired 8% of the share capital of the appellant and in 2009 it acquired the remaining share capital of the appellant. The appellant signed License Agreement and R&D Services Agreements with the US led group companies. These agreements were signed in July 2010, April 2011 and November 2011 having a retroactive effective date of April 25, 2009 (immediately after acquisition). During 2010, the appellant transferred eight or ten patents (out of 185 patents that were registered under its name at the time) to the parent company. (These assignments were not reported to the ITA and were not mentioned in the financial statements of the appellant which were filed with its tax returns.) Eventually, the appellant's technology failed, and in 2012, the appellant discontinued its business activity and did not report any income in connection with the termination of its business.

The tax authority claimed that the appellant's activities had essentially become an extension of the parent company's interest in the appellant, and under the parent company's direct management and supervision - effectively transferring its FAR to the parent company and thus recognized taxable capital gain with respect to the value of the overall business. Tax authority placed its reliance on the OECD guidelines stating that emphasis should be placed on the economic substance and not on the legal cover.

The appellant argued that the transactions were structured for business purposes, and accordingly, tax evasion and/or avoidance of tax were not relevant to this case. In addition, the lack of intention to sell the IP and the intercompany agreements supported such arguments.

The court reviewed the intercompany agreements and overall conduct of the parties and concluded that the appellant transferred its FAR outside of Israel to the parent company and its affiliates.

The court went in detail to analyze every fact and aspect of the case including the following and ruled in the favor of the tax authority:

The license agreement was for the entire duration of the remaining useful life of the IP

The appellant had given Medtronic a full and complete right to make use of the appellant's intellectual property, including the possibility of making changes thereto, almost throughout the entire economic life of the intellectual property.

Important Rulings

Registration of patents in the name of the parent company

The appellant was unable to substantiate its claim that the assignment of the patents was a "clerical error" or that the value or the importance of the relevant patents was insignificant. (Expressing a doubt as to the possibility for such an error to take place in such a large multinational group).

The legacy IP could not be separated from the new IP

The appellant's IP was at its early stages of development. The connection with, and eventually the acquisition by, the parent company was necessary to allow the appellant to continue the development and bring its IP to maturity. This fact was interpreted by the court to mean that the formal separation of the legacy IP from the new IP was unrealistic in this case.

The parent company essentially used the appellant's pre-mature IP and tailored it to its own purposes and business interests. The focus of the deal, according to the court, was not the legacy IP but rather the new IP to be developed by the appellant. The court noted that in this case the license and services agreements should be viewed as "replacing risk with return", i.e., replacing the option of high-reward and high-risk activity with lower-reward and lower-risk activity.

The fact that according to the inter-company agreements, the weight of the future intellectual property owned by the parent company will increase, at the expense of the weight of the previous intellectual property that allegedly remains owned by the appellant, also shows that in practice it was a sale.

Entity Characterization of the appellant - subcontractor for the Group

The continuation of the appellant's activity in Israel, even while preserving and increasing its manpower, was done in a manner consistent with the wishes of the parent company and its goals, and therefore there was nothing to testify that the control of the central functions did not leave the appellant, or that its managers have a central and essential role.

Under these circumstances, even the method in which the remuneration was determined in the R&D agreement – "cost plus", is in this case more consistent with the conclusion that the ability to make decisions and control the main functions that the appellant had before the acquisition were no longer in her hands, and in any case the risks involved in the continuation of her activity were also transferred to the parent company, implying the parent company to be the owner of the IP for all intents and purposes, essentially turning the appellant to a subcontractor for the Group.

Signing of agreements just before the cessation of appellant's activities

The court determined that the timing of the agreements — signed soon before the appellant's shutdown — supports the conclusion that they were used to cover the actual underlying transaction. The court found it difficult to accept that a multinational group would operate without written agreements.

The Court noted that the conduct of the parties showed that the said transaction deviated from the formal provisions of the R&D and license agreements and that in essence it was a transaction in which the appellant sold all of its assets, until in 2012 its activity was completely

Important Rulings

Coverage

stopped in accordance with the decision of the parent company and for reasons related toit and its own business plans. The appellant did not transfer any IP or know-how to the parent company when its business was terminated. It was clear from the evidence that the parent company already had the relevant know-how by such time, which in the court's view proved that some IP had previously been transferred.

Value of FAR sold

The Court adopted the value based on the transaction for the acquisition of all the shares of the appellant. The court did not categorically reject the notion - whether the acquisition value of the appellant may be reduced by a "control premium". In addition, the Court also noted the high value that the parent company was willing to pay for the appellant's shares reflected "synergy," which – is not a separate asset.

The Court also determined that the tax authority was authorized to impose a secondary adjustment.

A very important precedent regarding FAR transfers and post-acquisition business restructuring, setting the OECD guidelines as a base, this ruling emphasizes the importance of the conduct of the international groups following the acquisition of an Israeli company, and the manner in which they develop and implement intercompany relationship - edifying the action points and takeaways for Israeli affiliates of multinational enterprises, especially when compared with previous court rulings in which appellants managed to prove that FAR was not transferred.

MAM: ITAT Upholds assessee's TNMM over TPO's CUP method for determining ALP of technical service fee

[Menzies Bobba Ground Handling Services Private Limited [TS-445-ITAT-2023(HYD)-TP]]

The assessee is engaged in providing ground handling services in the nature of ticketing, checking, load control, aircraft loading and unloading, etc. The assessee has taken technical advice and support in relation to its ground-handling business from its AE and paid technical service fee towards the same.

The TPO rejected TNMM as the most appropriate method as applied by the assessee for the ALP could be determined and, therefore TNMM is the most appropriate method.

The ITAT, taking cognizance of the HC ruling in the case of M/s. Knorr Bremse India Pvt. Ltd.,[1] held that when the TPO did not bring on record any instance where comparable services were provided to an independent enterprise in the recipient market, the CUP method was not the most appropriate method, but on the contrary, TNMM method would be most appropriate method, because it was difficult to apply the CUP method or the cost plus method in such situation. Accordingly, the ITAT held that the TNMM was the most appropriate method in the absence of CUP which is applicable where the nature of the activities involved, assets used, and risk assumed are comparable to those undertaken by an independent enterprise.

[1] *DCIT vs. M/s. Knorr Bremse India Pvt. Ltd., ITA No. 3219/Del/2018*

Important Rulings

Also, following the rule of consistency as supported by the Supreme Court in many cases including Radhasoami Satsang[2] it is not open for the Revenue to take various stands for various years and the rule of Consistency demands that in case of a particular assessee under identical circumstances, different views cannot be taken.

ITAT lastly notes assessee's submission that authorities mistakenly followed Press Note-2 (2003 series), which was superseded by Press Note-8 (2009 series) wherein the cap on payment of royalty / payments towards technical services was removed; and was decided to permit payments for royalty, lumpsum fee for transfer of technology, etc. on the automatic route i.e., without any Government approval, and there is no cap for such payment as was there in the earlier press note.

[2] *Radhasoami Satsang vs. CIT [1991] 100 CTR 267 (SC)*

Important Updates

New Transfer Pricing Record Regulations in UK

The UK government introduced new transfer pricing record requirements on July 19, 2023. The new regulations are applicable from the accounting year beginning on or after April 1, 2023. The key regulations are as follows:

Applicability – UK entities that are members of an MNE group that meets the CbCR threshold ('the MNE group test') and have material-controlled transactions.

A UK entity includes a UK resident company, partnership firm or a trust that is required to file a tax return in the UK;

MNE group is considered to meet the MNE group test when two member entities of the MNE group are resident in two different jurisdictions and their consolidated group revenue exceeds EURO 750 million.

Requirement of Records – Applicable entities are required to prepare and maintain Master File, Local File and supplementary information relating to preparation of the Local File i.e., Summary Audit Trail (SAT). The details to be mentioned and records to be maintained for SAT will be published by HMRC in later 2023.

In cases where an MNE group prepares a single Master File and makes the document available to all relevant persons for UK entities within the group to provide to HMRC upon request, the relevant person will be considered as meeting its record-keeping obligations in relation to the Master File. In these circumstances, each UK member of the MNE group is not required to prepare a separate Master File and can instead rely on a single Master File.

Even when the MNE group test is not met, it is recommended to prepare documentation in an appropriate way to demonstrate that provisions between related parties adhere to the arm's length principle as per OECD Transfer Pricing Guidelines.

Contemporaneous Transfer Pricing Documentation – to be updated annually and submitted within 30 days upon request by the HMRC.

Aliment with revised OECD Transfer Pricing Guidelines - The new TP record requirements have been aligned with the revised OECD Transfer Pricing Guidelines (updated in January 2022).

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RBI Notifications

Reserve Bank of India clarifies on Star Series Banknotes

Press Release 2023-2024/653 dated 27 July 2023

Fresh banknotes issued by RBI till August 2006 were serially numbered distinctively with a prefix consisting of numerals and letters and the same were issued in packets containing 100 pieces. RBI adopted the "STAR series" numbering system for replacement of defectively printed banknote. The Star series banknotes are exactly similar to the other banknotes, but have an additional character viz., a *(star) in the number panel in the space between the prefixes. Consequent to various ongoing discussions on different social media platforms, RBI has clarified that such Star symbol is merely an identifier of replaced/reprinted bank notes, and the Star series banknotes continue to be legal and valid.

Reserve Bank of India and Central Bank of the UAE sign two MoUs to (i) establish a Framework to Promote the Use of Local Currencies for Cross-border Transactions and (ii) cooperation for interlinking their payment and messaging systems

Press Release 2023-2024/604 dated 15 July 2023

In order to boost seamless cross border transactions and payments between India and UAE and foster INR-AED foreign exchange market, the Reserve Bank of India (RBI) and the Central Bank of UAE (CBUAE) have signed two MoUs in Abu Dhabi thereby establishing a framework for use of INR and AED bilaterally by way of creating Local Currency Settlement System (LCSS). The salient features of the framework are as under:

(i) **Scope:** All current account transactions and all the permitted capital account transactions;

(ii) **Framework:** linking Fast Payment Systems (FPSs) – Unified Payments Interface (UPI) of India with Instant Payment Platform (IPP) of UAE and linking RuPay switch and UAESWITCH along with exploring linking of payments messaging systems.

(iii) **Advantages:**

- Creation of LCSS would enable exporters and importers to invoice and pay in domestic currency;
- Promote trade, investments, and remittances between the two countries; and
- Mutual acceptance and processing of domestic cards and cost-effective cross border fund transfers.

SEBI Notifications

Trading supported by blocked amount in Secondary Market

SEBI / HO / MRD / MRD-PoD-2/P / CIR / 2023 / 99 dated June 23, 2023

SEBI introduced supplementary process (i.e.) another option to investor, for trading in secondary market based on blocked funds in investor's bank account, instead of transferring them upfront to the Trading Member (TM), thereby providing enhanced protection of cash collateral.

The facility will be provided by integrating Reserve Bank of India (RBI) approved Unified Payments Interface (UPI) mandate service of single-block-and-multiple-debits with the secondary market trading and settlement process, referred to as 'UPI block facility'.

Under the proposed framework, funds shall remain in the bank account of the client but will be blocked in favor of the clearing corporation (CC) till the block is released by the CC, or debit of the block towards obligations arising out of the trading activity of the client, whichever is earlier. Further, settlement for funds and securities will be done by the CC without the need for handling of client funds and securities.

Availing UPI block facility shall be at the option of the investor, wherein an investor with trading accounts across multiple stockbrokers can have a choice to avail UPI block facility under some broker(s) and non-UPI based trading under others.

Collateral and settlement shall continue to remain segment-wise, and the client/TM/CM shall need to transfer/reallocate collateral between segments.

Single block limit of Rs. 5 lakhs shall apply [as currently applicable for UPI based securities market transaction], with the provision for co-existence of multiple blocks subject to the overall limit applicable in UPI.

Applicability: January 01, 2024.

Investor Service Centers of Stock Exchanges

SEBI / HO / MRD / MRD – POD - 3 / CIR / P / 2023 / 104 dated June 26, 2023

SEBI vide Circular No. SMD/POLICY/CIR-32/97 dated December 03, 1997, advised all stock exchanges to open or maintain at least one Investor Service Centre (ISC) for the benefit of the investors. Such centers were required to provide counseling services and certain basic minimum facilities to the investors. The major stock exchanges were allowed to open as many ISCs as required.

Thereafter in 2013 it was mandated that apart from the ISCs operating in metro cities (viz., New Delhi, Mumbai, Chennai, and Kolkata), stock exchanges having nationwide terminals were required to open ISCs in Ahmedabad, Hyderabad, Kanpur, Indore, Bangalore, Pune, Jaipur, Ghaziabad, Lucknow, Gurgaon, Patna, and Vadodara.

With significant development in the securities market including technological advancements, SEBI has revisited the existing provisions and directed the Stock Exchanges to take the following initiatives:

1) Exchanges to open additional ISCs wherever required whether singly or jointly.
2) The following basic facilities have to be provided to each ISC:
    a. Four financial daily newspapers with at least one in the regional language of the place where the ISC is situated.
    b. Dedicated desktop or laptop with internet connectivity to enable the investors to access various relevant information available in public domain and also to access SEBI's and

stock exchange's grievance redressal portals.

c. Facilities for receiving investor complaints in both physical and electronic form.

d. Facilitation desks at all ISCs to assist the investors in the dispute resolution process.

e. Arbitration and appellate arbitration facility at all ISCs including video-calling facility to investors.

Applicability: With effect from 90th day of issuance of circular (i.e.) from September 26, 2023.

Regulatory Framework for sponsors of a Mutual Fund

SEBI / HO / IMD / IMD – PoD – 2 / P/CIR/2023/118 dated July 07, 2023

In order to facilitate new types of players to act as sponsors of Mutual Funds and to penetrate the mutual funds industry, SEBI introduced an alternative set of eligibility criteria with the objective of facilitating fresh flow of capital into the industry, fostering innovation, encouraging competition, providing ease of consolidation and easing exit for existing sponsors. SEBI formed a Working Group, and the recommendations of Working Group were deliberated in the Mutual Funds Advisory Committee and the following was decided:

1) **Deployment of liquid net worth by Asset Management Company (AMC)**: AMCs shall deploy the minimum net worth required either in cash, money market instruments, Government Securities, Treasury bills, Repo on Government securities.
2) **Acquisition of an AMC:** In case of a change in control of an existing AMC due to the acquisition of shares, the sponsor will have to ensure that the positive liquid net worth of the sponsor is to the extent of aggregate par value or market value of the shares proposed to be acquired, whichever is higher.
3) **Pooled Investment Vehicle as sponsor of Mutual Funds:** Among the pooled investment vehicles, only the private equity funds (PEs) can sponsor a Mutual Fund.
4) **Reduction of stake and disassociation of sponsor:** AMC can become a "self- sponsored AMC" subject to fulfillment of certain conditions.
5) **Re- Association of the Sponsor(s):** A disassociated sponsor and/or any new entity can become sponsor of a Mutual Fund subject to the fulfilment of certain conditions.

Applicability: Provisions related to deployment of mutual funds will be effective from January 1, 2024, and other provisions will be effective from August 01, 2023.

Roles and responsibilities of Trustees and board of directors of Asset Management Companies (AMCs) of Mutual Funds

SEBI/HO/IMD/IMD-PoD-1/P/CIR/2023/117 dated July 07, 2023

SEBI had constituted a Working Group to streamline the responsibilities of the Trustees as the Trustees hold the property of the Mutual Fund in trust for the benefit of the unit holders and their primary role is to ensure that AMCs appointed by them act in the best interests of the unitholders.

Based on the recommendations of the Working Group and the Mutual Fund Advisory Committee (MFAC), the "core" responsibilities for the Trustees of a Mutual Fund have been specified to include the following:

SEBI Notifications

1) Ensure fairness of the fees and expenses charged by the AMC.
2) Review the performance of AMC in its schemes vis-a-vis performance of peers or the appropriate benchmarks.
3) Put in place adequate systems to prevent mis-selling to increase assets under their management and valuation of the AMCs.
4) Ensure that operations of AMCs are not unduly influenced by the AMCs Sponsor, its associates and other stakeholders of AMCs.
5) Ensure that undue or unfair advantage is not given by AMCs to any of their associates/group entities.
6) Address conflicts of interest, if any, between the shareholders/stakeholders/associates of the AMCs and unitholders.
7) Ensure that there are system level checks in place at AMCs' end to prevent fraudulent transactions by its employees / distributors etc.
8) Submit exception reports/analytical information to the Trustees, that add value to the process of exercising their oversight role.

Applicability: From January 01, 2024

Disclosure of material events/ information by listed entities under Regulations 30 and 30A of SEBI (LODR) Regulations, 2015

SEBI / HO / CFD / CFD – PoD – 1 / P / CIR / 2023 / 123 dated July 13, 2023

In order to bring more transparency and to ensure timely disclosure of material events / information by listed entities, the proposal to amend LODR Regulations was deliberated by the Primary Market Advisory Committee (PMAC) of SEBI and subsequently placed for public consultation for comments. This circular consists of four annexures with respect to disclosure requirements under Regulation 30 and 30A of LODR regulations:

1) **ANNEXURE I** specifies the details that need to be provided while disclosing events i.e., acquisition, Amalgamation/Merger, De-Merger or any other restructuring, issuance of securities, split/consolidation of shares, Buy-Back and other events as specified in Part A of Schedule III.
2) **ANNEXURE II** specifies the timeline for disclosing events specified in Part A of Schedule II.
3) **ANNEXURE III** provides guidance on when an event / information can be said to have occurred.
4) **ANNEXURE IV** provides guidance on the criteria for determination of materiality of events / information.

Applicability: From July 15, 2023

Trading Window Closure Period: Extending framework for restricting trading by Designated Persons ("DPs") by freezing PAN at security level to all listed companies in a phased manner

SEBI / HO / ISD / ISD – PoD – 2 / P / CIR / 2023 / 124 dated July 19, 2023

Clause 4(1) of Schedule B read with Regulation 9 of PIT Regulations states that the trading window should be closed when the Compliance Officer (of the listed entity) determines that a designated person or class of designated persons can be expected to have possession of Unpublished Price Sensitive Information (UPSI). Such closure shall be imposed in relation to such securities to which such UPSI relates. Designated persons and their immediate relatives should not trade in securities when the trading window is closed.

SEBI Notifications

SEBI vide circular SEBI/HO/ISD/ISD-SEC-4/P/CIR/2022/107 dated August 05, 2022, laid down a framework to freeze the permanent account number (PAN) of Designated Persons (DPs) during the "trading window closure" at the security level for listed entities that were part of benchmark indices i.e. NIFTY 50 and SENSEX to restrict the trading by Designated Partners.

Given the satisfactory implementation of the framework for the listed companies forming part of benchmark indices SEBI has now extended the restrictive trading to all the listed companies in a phased manner.

The *Glide Path* specifying the timelines for phase wise implementation of framework is prescribed below:

Sr. No.	Companies to be covered	PAN Freeze start date
1	Listed companies that are part of benchmark indices i.e., NIFTY 50 and SENSEX	Already applicable as on date
2	Top 1,000 companies in terms of BSE Market Capitalization as of June 30, 2023 (excluding companies' part of benchmark indices)	October 1, 2023
3	Next 1,000 companies in terms of BSE Market Capitalization as of June 30, 2023	January 1, 2024
4	Remaining companies listed on BSE, NSE & MSEI	April 1, 2024
5	Companies getting listed on Stock Exchanges post issuance of this circular	1st day of the second quarter from the quarter in which*

**For a company getting listed during January 01 to March 31, 2023, PAN of DPs should be frozen at security level as per prescribed framework latest from July 01, 2023.*

This move aimed at preventing inadvertent trading by designated persons during the trading window period, ensuring fair and compliant practices in the Indian stock market. SEBI vide this circular also prescribed the procedure for implementation of system and format of submission of quarterly report to SEBI.

Applicability: As per the Glide Path

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For further analysis and discussion, you may please reach out to us.

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Abbreviations

Abbreviation	Meaning
AA	Advance Authorisation
AAR	Authority of Advance Ruling
AAAR	Appellate Authority of Advance Ruling
AAC	Annual Activity Certificate
AD Bank	Authorized Dealer Bank
AE	Associated Enterprise
AGM	Annual General Meeting
AIR	Annual Information Return
ALP	Arm's length price
AMT	Alternate Minimum Tax
AO	Assessing Officer
AOP	Association of Person
APA	Advance Pricing Arrangements
AS	Accounting Standards
ASBA	Applications Supported by Blocked Amount
AY	Assessment Year
BAR	Board of Advance Ruling
BEAT	Base Erosion and Anti-Avoidance Tax
CBDT	Central Board of Direct Tax
CBIC	Central Board of Indirect Taxes and Customs
CCA	Cost Contribution Arrangements
CCR	Cenvat Credit Rules, 2004

Abbreviation	Meaning
CESTAT	Central Excise and Service Tax Appellate Tribunal
CGST Act	Central Goods and Service Tax Act, 2017
CIT(A)	Commissioner of Income Tax (Appeal)
COO	Certificate of Origin
Companies Act	The Companies Act, 2013
CPSE	Central Public Sector Enterprise
CSR	Corporate Social Responsibility
CTA	Covered Tax Agreement
CUP	Comparable Uncontrolled Price Method
Customs Act	The Customs Act, 1962
DFIA	Duty Free Import Authorization
DFTP	Duty Free Tariff Preference
DGFT	Directorate General of Foreign Trade
DPIIT	Department of Promotion of Investment and Internal Trade
DRI	Directorate of Revenue Intelligence
DTAA	Double Tax Avoidance Agreement
ECB	External Commercial Borrowing
ECL	Electronic Credit Ledger
EO	Export Obligation
EODC	Export Obligation Discharge Certificate

Abbreviation	Meaning
EPCG	Export Promotion Capital Goods
FEMA	Foreign Exchange Management Act, 1999
FII	Foreign Institutional Investor
FIFP	Foreign Investment Facilitation Portal
FIRMS	Foreign Investment Reporting and Management System
FLAIR	Foreign Liabilities and Assets Information Reporting
FPI	Foreign Portfolio Investor
FOCC	Foreign Owned and Controlled Company
FTC	Foreign Tax Credit
FTP	Foreign Trade Policy 2015-20
FTS	Fees for Technical Service
FY	Financial Year
GAAR	General Anti-Avoidance Rules
GDR	Global Depository Receipts
GMT	Global Minimum Tax
GILTI	Global Intangible Low-Taxed Income
GSTN	Goods and Services Tax Network
GVAT Act	Gujarat VAT Act, 2006
HSN	Harmonized System of Nomenclature
IBC	Insolvency and Bankruptcy Code, 2016

Abbreviations

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Abbreviation	Meaning
ICDS	Income Computation and Disclosure Standards
ICDR	Issue of Capital and Disclosure Requirements
IEC	Import Export Code
IIR	Income Inclusion Rule
IMF	International Monetary Fund
IRP	Invoice Registration Portal
IRN	Invoice Reference Number
ITC	Input Tax Credit
ITR	Income Tax Return
IT Rules	Income Tax Rules, 1962
ITAT	Income Tax Appellate Tribunal
ITR	Income Tax Return
ITSC	Income Tax Settlement Commission
JV	Joint Venture
LEO	Let Export Order
LIBOR	London Inter Bank Offered Rate
LLP	Limited Liability Partnership
LOB	Limitation of Benefit
LODR	Listing Obligations and Disclosure Requirements
LTA	Leave Travel Allowance
LTC	Lower TDS Certificate

Abbreviation	Meaning
LTCG	Long term capital gain
MAT	Minimum Alternate Tax
MCA	Ministry of Corporate Affairs
MeitY	Ministry of Electronics and Information Technology
MSF	Marginal Standing Facility
MSME	Micro, Small and Medium Enterprises
NCB	No claim Bonus
OECD	The Organization for Economic Co-operation and Development
OM	Other Methods prescribed by CBDT
PAN	Permanent Account Number
PE	Permanent establishment
PPT	Principle Purpose Test
PSM	Profit Split Method
PY	Previous Year
QDMTT	Qualified Domestic Minimum Top-up Tax
RA	Regional Authority
RMS	Risk Management System
ROR	Resident Ordinary Resident
ROSCTL	Rebate of State & Central Taxes and Levies
RoDTEP	Remission of Duties and Taxes on Exported Products

Abbreviation	Meaning
RPM	Resale Price Method
SC	Supreme Court of India
SCN	Show Cause Notice
SDS	Step Down Subsidiary
SE	Secondary adjustments
SEBI	Securities Exchange Board of India
SEP	Significant economic presence
SEZ	Special Economic Zone
SFT	Specified Financial statement
SION	Standard Input Output Norms
SOP	Standard Operating Procedure
ST	Securitization Trust
STCG	Short term capital gain
SVLDRS	Sabka Vishwas (Legacy Dispute Resolution Scheme) 2019
TCS	Tax collected at source
TDS	Tax Deducted at Source
TNMM	Transaction Net Margin Method
TP	Transfer pricing
TPO	Transfer Pricing Officer
TPR	Transfer Pricing Report
TRO	Tax Recovery Officer
UTPR	Undertaxed Profits Rules
WHT	Withholding Tax
WOS	Wholly Owned Subsidiary