KPMG Tax Alert

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KPMG IN INDIA

Welcome to Tax Alert, KPMG's Knowledge Management Team’s update on tax, corporate and allied laws. This newsletter updates you with the important and latest notifications/circulars and decisions of Courts and Tribunals.

While we are pleased to have you on our mailing list, if for any reason you do not wish to receive future issues, please let us know.

We look forward to receiving your valuable feedback about the newsletter at mknowledge@in.kpmg.com and we shall be happy to respond to your queries concerning the information provided here.

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Direct Tax -
Decisions

Employer's as well as Employee's contribution towards PF/ESI after the due date prescribed under the relevant Act/Rules but before the date of filing return is an allowable expenditure

The taxpayer filed its return of income after declaring income at INR 795,430. During the assessment proceedings, the Assessing Officer (AO) observed that that the taxpayer had deposited employers' as well as employees' contribution towards Provident Fund/ESI after the due date, as prescribed under the relevant Act/Rules. Accordingly, the AO made an addition of employees contribution under section 36(1)(va) and employers contribution under section 43B of the Income-tax Act, 1961 (the Act).

The Income-tax Appellate Tribunal (the Tribunal) after relying on the decision of the Supreme Court in the case of CIT v. Vinay Cement Ltd. [2007] (213 CTR 268) held that the amount would qualify for deduction even if paid after the due dates prescribed under the relevant Act but before the filing of the Income-tax returns.

The High Court observed various judicial pronouncements wherein amounts paid on account of PF/ESI after due date were allowed as deduction in view of section 43B, read with section 36(1)(va) of the Act. Further, the High Court held that if the employees' contribution is deposited beyond due date prescribed under the relevant Acts then the employer not only pays interest on delayed payment but it can incur penalties also, for which specific provisions are made in the Provident Fund Act as well as ESI Act. Therefore, the Act permits the employer to make the deposit with some delays, subject to the aforesaid consequences.

Accordingly, the High Court held that employer's as well as employee's contribution amount deposited by the taxpayer towards PF/ESI after the due date, as prescribed under the relevant Act/Rules, but before date of filing return was allowable expenditure.

CIT v. AIMIL Limited (ITA No.1063/Del/2008)
(Judgment date: 23 December 2009, AY 2002-03)

The treatment given to a particular transaction in prior years cannot be changed by tax department unless there is a valid reason for deviation from the same

The taxpayer, a subsidiary of US based company, made an application under section 195(2) of the Act to the AO seeking that no tax was required to be deducted on payment made to the parent company for administrative service provided during Assessment Year (AY) 2003-04 to 2005-06. During AY 2002-03 only 25 percent of the administrative service fees paid to the parent company was treated as income and subject to tax in India based on the Mutual Agreement Procedure (MAP) agreed between the taxpayer and the tax department. Hence, no tax was required to be deducted at source from payment of administrative service to parent company for the AY 2003-04 to 2005-06 also.

However, the AO rejected the application filed under section 195(2) of the Act and held that tax needs to be withheld on accrual/payment of administrative service fees. The CIT (A) confirmed the order of AO.

The Tribunal observed that the taxpayer as well as the tax department in preceding years i.e. AY 2001-02 and 2002-03 as well as succeeding years i.e. AY 2008-09 and 2009-10 agreed that 25 percent of the administrative service fees paid to the holding company would be treated as income and subject to tax in India. However, for AY 2003-04 to 2005-06 the AO rejected the application filed under section 195(2) of the Act. However, the tax department failed to bring material on record to justify its inconsistent approach in similar set of circumstances and such inconsistent approach is not justified. Similar view has to be taken in similar circumstances, unless there is a valid reason for the deviation from the same.

Accordingly, the Tribunal set aside the order of CIT(A) and restore the matter to AO with a direction to decide the matter as per facts available on record and as per law available at the relevant point of time, after providing due opportunity of being heard to the taxpayer. It is pertinent to note here that, since the Tribunal set aside the matter due to inconsistency, it refrained from making comment on the merits of the issue.

M/s Herbalife International India Pvt. Ltd v ITO (2010-TIOL-63-ITAT-BANG) (Judgment date: 23 December 2009, AY 2003-04 to 2005-06)

Prior period interest paid to the bank during the year was allowable under section 43B of the act with effect from assessment year 1997-98 even when there was no business activity

The taxpayer filed its return of income after admitting a loss of INR 6.8 million. The taxpayer paid an interest of INR 7 million to the bank and claimed as revenue expenditure. On verification of records, the AO observed that there was no business activity during the year and interest of INR 2.6 million was crystallised prior to 31 March 1996. The taxpayer contended that such interest was paid on loan taken for business only and since such interest payment was made during the year under consideration the same has to be allowed as a deduction as per the provisions of section 43B of the Act. However, the AO rejected the taxpayer's contentions and held that since the provision related to payment of interest on term loans under section 43B of the Act was introduced for the AY 97-98 and therefore, the interest relating to AY 96-97 cannot be allowed. The CIT(A) held that since the taxpayer paid the interest of the preceding year in the current year, such interest was allowable under section 43B of the Act.

The Tribunal after considering the decision of the Supreme Court in the case of Allied Motors (P) Limited v. CIT [1997] (224 ITR 677) and Circular no.762, dated 18 February 1998 held that the amendment to the provisions of section 43B of the Act allowing the interest expenditure paid to the scheduled banks in the year of payment was applicable from AY 1997-98. Accordingly, the Tribunal allowed the interest expenditure claimed by the taxpayer.

ACIT v. M/s Blue Mountain Food Products Ltd. [2009-TIOL-787-ITAT-BANG] (Judgment date: 17 April 2009, AY 1997-98)

Interest-free loans by Indian companies to foreign subsidiaries do not comply with the arm's length standard

In the recent ruling in the case of Perot Systems TSI (India) Private Limited, the Delhi Tribunal has held that interest free-loan by taxpayer to foreign subsidiaries does not comply with the arm's length standard. The Tribunal has further held that the benefit of +/- 5 percent safe harbour, as provided in the provision to section 92C(2) of the Act, is not available in respect of the loan transactions where standard bank rates (like LIBOR) are used as benchmark, considering that the safe harbour is available only where more than one arm's length price is determined.

For further details please refer to our Flash News dated 3 February 2010 available at in.kpmg.com

Recent Transfer Pricing decision by Chandigarh Tribunal (Special Bench)

In the recent ruling in the case of Quark Systems Private Limited, the Special Bench of Chandigarh Tribunal while adjudicating the matter and remanding certain issues back to the files of the Assessing Officer has re-stated the 'critical importance' of conducting a detailed FAR analysis (i.e. functions performed, assets used, and risk assumed) of the tested party and the comparables. In addition, the Tribunal has also provided useful guidance on some of the basic parameters which needs to be reckoned while undertaking comparability analysis.

For further details please refer to our Flash News dated 3 February 2010 available at in.kpmg.com

Payment received from third party re-sellers on account of supplies of software products to end users is neither taxable as royalty nor business profits within the provisions of India-Japan tax treaty and the Income-tax Act

Recently, the Authority for Advance Ruling (AAR) in the case of Dassault Systems KK held that the payments received from supply of software products cannot be considered as 'royalties' taxable under the provisions of the Act or under the India-Japan tax treaty. It is characterised as 'business profits', however, in the absence of a Permanent Establishment of the non-resident supplier in India, such payments was held to be not taxable in India.

For further details please refer to our Flash News dated 5 February 2010 available at in.kpmg.com

Acquisition of the participatory rights in the nature of license acquired by the taxpayer was eligible for depreciation under section 32 of the Act

Recently, the Delhi bench of the Tribunal in the case of ONGC Videsh Ltd. has held that the participatory right acquired by the taxpayer pursuant to Production Sharing Agreements with one of the consortium member was in the nature of asset, in the form of 'license' to have an access and to carry out exploration, development, and production of hydrocarbons operations. Accordingly, such asset was eligible for depreciation under section 32 of the Act.

For further details please refer to our Flash News dated 5 February 2010 available at in.kpmg.com

The Mumbai Tribunal disallowed the claim of the taxpayer in providing interest free loans to its overseas subsidiary

Recently, the Mumbai Tribunal in the case of VVF Limited held that the taxpayer was not justified in providing interest free loans to its overseas subsidiary. The Tribunal rejected the arguments of the tax payer that the loan was extended on account of commercial expediency and out of its own fund (i.e. interest free).

For further details please refer to our Flash News dated 8 February 2010 available at in.kpmg.com

The arm's length price of international transaction needs to adjudicated by necessarily adopting one of the prescribed methods

In an important judgment in the case of CA Computer Associates Pvt. Ltd., the Mumbai Tribunal, while ruling in favour of the taxpayer, has held that the bad debts incurred by the taxpayer can not be the determining factor for making an adjustment to the royalty payment which is the international transaction. The Tribunal further held it is necessary on the part of the Transfer Pricing Officer to adopt one of the prescribed methods while adjudicating the arm's length nature of international transaction.

For further details please refer to our Flash News dated 10 February 2010 available at in.kpmg.com

Mumbai Tribunal held that the withdrawal of circular no. 23 by CBDT is prospective in nature and it may not apply to the pending cases

Recently, the Mumbai Tribunal in the case of Siemens Aktiengesellschaft held that the withdrawal of circular no. 23 and 786 by Central Board of Direct Taxes is effective from 22 October 2009. Accordingly, it was held that the circular which was operational in AY 1998-99 cannot be held to be non operational simply because it has been withdrawn in the year 2009. The withdrawal of such circulars is likely to be effective only after 22 October 2009 and it cannot be applied to the year in which it was in operation.

For further details please refer to our Flash News dated 17 February 2010 available at in.kpmg.com

In the case of difference between the sales as per the books of accounts and the amount shown in the TDS certificate only the profit element is taxable and not the entire amount

Recently, the Cuttack Tribunal in the case of RR Carrying Corporation held that only the embedded portion of the profits is to be considered as taxable and not the entire amount in the case of discrepancies between the sales or receipt amount as per books of accounts and the amount shown in the TDS certificate, for taxability purpose. Accordingly, the Tribunal directed the Assessing Officer to adopt the gross profit rate declared by the taxpayer for the assessment year under consideration and compute the addition accordingly.

For further details please refer to our Flash News dated 18 February 2010 available at in.kpmg.com

Section 10A benefit is a deduction provision and since it is undertaking specific, the business losses of a non-eligible undertaking cannot be set off against profits of the eligible undertaking

Recently, Special Bench of the Chennai Tribunal in the case of Scientific Atlanta India Technology Pvt. Ltd. held that the benefits available under section 10A of the Act is a deduction and not an exemption. Further, since the deduction under section 10A of the Act is undertaking specific, the business losses of a non-eligible undertaking, whose income is not eligible for deduction under section 10A of the Act, cannot be set off against the profits of the eligible undertaking.

For further details please refer to our Flash News dated 19 February 2010 available at in.kpmg.com

The initial assessment year for the purpose of claiming benefit under section 80-IA of the Act, is the year in which the industrial undertaking begins commercial production and not the trail production

Recently, the Delhi High Court in the case of Nestor Pharmaceuticals Limited on the issue of whether the year in which trial production starts can be considered as initial AY for claiming benefit under section 80-IA of the Act after relying on various judicial precedents held, that the initial year is the year in which the commercial production starts and not the trial production.

For further details please refer to our Flash News dated 22 February 2010 available at in.kpmg.com

The Supreme Court referred to a larger bench on the issue of whether to provide depreciation as per Income-tax Act or as per Companies Act while computing book profits under section 115J of the Act

Recently, the Supreme Court, in the case of Dynamic Orthopedics Pvt. Ltd. on the issue of whether to provide depreciation as per Income-tax Rules, 1962 (the Rules) or as per Companies Act, 1956 while computing book profits under section 115J of the Act, has held that once the taxpayer falls within the ambit of Minimum Alternate Tax the taxpayer should prepare its profit and loss account as per parts II and III of schedule VI to the Companies Act, 1956. Accordingly, the depreciation should be provided as per the rates specified in schedule XIV of the Companies Act.

However, since the Supreme Court itself in its earlier decision in the case of Malayala Manorama Company Limited had taken contradictory view, the matter was placed with the larger bench for reconsideration.

For further details please refer to our Flash News dated 23 February 2010 available at in.kpmg.com

The Supreme Court ruled that with effect from 1 April 1989, to claim bad debts it is sufficient if the debt is written off as irrecoverable in the books of accounts of the taxpayer

Recently, the Supreme Court in the case of TRF Limited held that post amendment (with effect from 1 April 1989) to claim deduction for the bad debts under section 36(1)(iii) of the Act and it is not necessary for the taxpayer to establish that the debt has actually become irrecoverable. It is sufficient if the bad debt is written off as irrecoverable in the books of accounts of the taxpayer.

For further details please refer to our Flash News dated 23 February 2010 available at in.kpmg.com

Employee left India for the purpose of employment outside India - non resident if present for less than 182 days

Recently, the AAR has held in the case of Shri Anurag Chaudhary that an employee who has left India for the purpose of employment outside India would qualify as a non resident, if he was present in India for less than 182 days during a financial year. Further, it was held that the salary earned on account of employment outside India would not be taxable in India.

For further details please refer to our Flash News dated 24 February 2010 available at in.kpmg.com

Remittance to non-residents and withholding tax obligations Frequently Asked Questions ('FAQs'): recent challenge by Indian revenue

Given the mounting fiscal deficit, the Government is focused on increasing the tax collections. With the introduction of the new remittance procedure w.e.f. 1 July 2009, the Revenue is in a position to electronically track and monitor foreign remittances. Hence, it is probable that the revenue may increasingly scrutinse foreign remittances which have been effected without withholding taxes.

We are pleased to forward FAQs which have been designed to provide a handy guide to the industry for understanding the scope and implications of any enquiry which may originate from the Revenue, and for appropriately responding to such scrutiny.

For further details please refer to our Flash News dated 25 February 2010 available at in.kpmg.com

Direct Tax and Regulatroy -

Notifications/Circulars/ Press releases

Simplification of ECB policy by RBI

As per the existing External Commercial Borrowings Policy (ECB) procedures, any changes in the terms and conditions of the ECB after obtaining the Loan Registration Number (LRN) require the prior approval of the Reserve Bank of India (RBI).

Now, it has been decided to delegate powers to the designated Authorised Dealers (AD) to approve the following requests from the ECB borrowers availed form approval as well as automatic routes, subject to specified conditions:

- **Changes/modifications in the drawdown/repayment schedule**
  If the condition that the average maturity period, as declared while obtaining the LRN, is maintained then the designated AD may approve modifications in the drawdown/repayment schedule of the ECBs already availed. Such changes in the drawdown or repayment schedule should be promptly reported to the Department of Statistics and Information Management (DSIM), RBI. However, any rollover in the repayment on expiry of the original maturity of the ECB would require the prior approval of the Reserve Bank
- **Changes in the currency of borrowing**
  The designated AD may allow changes in the currency of borrowing, in respect of ECBs availed by the borrower company, subject to many other terms and conditions of the ECB remaining unchanged. However, designated AD banks should, determine that the proposed currency of borrowing is freely convertible
- **Change of the AD bank**
  Designated AD may allow change of the existing designated AD bank by the borrower company for effecting its transactions pertaining to the ECBs subject to No-Objection Certificate (NOC) from the existing designated AD bank and after due diligence
- **Changes in the name of the borrower company**
  Designated AD may allow changes in the name of the borrower company subject to production of supporting documents evidencing the change in the name from the Registrar of Companies.

The above modifications to the ECB guidelines are likely to come into force with immediate effect.

A. P. (DIR Series) Circular No.33, dated 9 February 2010

Foreign Trade (Development and Regulation) Amendment Bill, 2009

Government had enacted the Foreign Trade (Development and Regulation) Act, 1992 ('the Act') to enable development and regulation of foreign trade by facilitating imports and enhancing exports from India.

Recently, a need was felt to amend the Act, in order to address certain requirements like bringing in tighter export/trade control in case of dual use goods and related technologies, foster conformity with India's commitments to WTO/other international agreements and to safeguard the domestic industry. Accordingly, Foreign Trade (Development and Regulation) Amendment Bill, 2009 ('the Bill') is proposed to amend the Act.

For further details please refer to our Flash News dated February 2010 available at in.kpmg.com

Adjustment of FBT paid towards the advance tax liability for FY 2009-10

The CBDT has issued a Circular (dated 29 January 2010) which enables the adjustment of any FBT instalment paid by a tax payer for financial year 2009-10 towards the advance income-tax liability for the said financial year.

For further details please refer to our Flash News dated 1 February 2010 available at in.kpmg.com

Revised guidelines for the grant of employment visas to foreign nationals

The Ministry of Labour and Employment and Training has issued revised guidelines regarding eligibility criteria in respect of issuance of Employment Visas to Foreign Nationals coming to India for execution of projects in India.

For further details please refer to our Flash News dated 9 February 2010 available at in.kpmg.com

India-Hungary social security agreement

Recently, the Government of India had signed a Social Security Agreement (SSA) with Hungary to avoid the hardship of double payment of social security (by employer and employee) in India and Hungary. It likely to encourage the movement of the cross-border employees between the two countries. The SSA may come into force from a date which is likely to be notified separately.

For further details please refer to our Flash News dated 10 February 2010 available at in.kpmg.com

India and Denmark sign social security agreement

Recently, the Government of India had signed SSA with Denmark to avoid the hardship of double payment of social security (by employer and employee) in India and Denmark. It is likely to encourage the movement of the cross-border employees between the two countries.

The SSA may come into force from a date which is likely to be notified separately.

For further details please refer to our Flash News dated 18 February 2010 available at in.kpmg.com

Indian economic survey 2009-10 – Key highlights

On 25 February 2010, the Finance Minister presented the "Economic Survey 2009-10" before the Parliament. It is a report card of India's economic performance which gives the current and expected direction of the Government Policies.

For further details please refer to our Flash News dated 25 February 2010 available at in.kpmg.com

Reintroduction of the erstwhile Income-tax Rules with regard to the TDS/TCS provisions

The CBDT had made certain amendments on 25 March 2009 in respect of the Tax Deduction at Source (TDS)/Tax Collection at Source (TCS) payments and related compliance requirements. The CBDT has now reintroduced the erstwhile Income-tax Rules which prevailed before enacting the above said amendments, with a few changes. The new rules shall be effective from 1 April 2009.

For further details please refer to our Flash News dated 25 February 2010 available at in.kpmg.com

KPMG Budget 2010 highlights

The Finance Minister presented the Union Budget 2010, before the Parliament on 26 February 2010.

The attached Tax Alert, highlights the salient features of the Finance Bill, 2010, in terms of direct and indirect taxes. Unless otherwise indicated, the proposed amendments relating to direct taxes is likely to apply from assessment year 2011-12 and the changes in the rates of Central Excise and Customs Duties come into effect immediately. Further, changes in Service tax provisions is likely to come into effect on the enactment of the Finance Bill, 2010 or from a date to be notified thereafter.

For further details please refer to our Flash News dated 26 February 2010 available at in.kpmg.com

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