Deloitte.

Quarterly India Tax updates

October – December 2018

January 2019

IndiaTaxHour

Presenters

Subject matter experts

We will discuss…

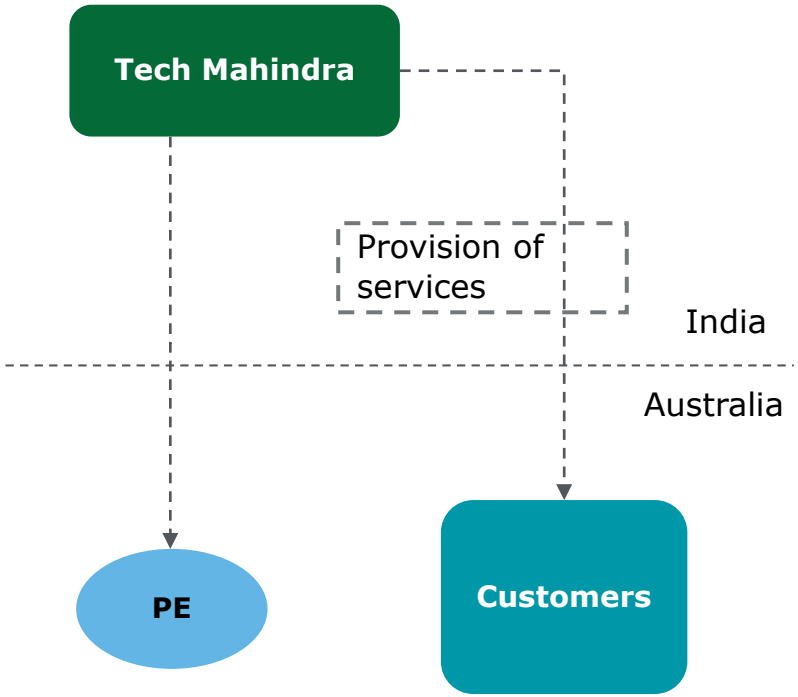
1. Treaty Interpretation
2. Conversion of company to LLP
3. Research & Development Expenses
4. Indirect Tax

Treaty interpretation

- Satyam Computer Services Limited (now Tech Mahindra Limited) and Commissioner of Taxation [2018] NSD 1648, 1649, 1650 of 2017 (Federal Court of Australia)
- Alta Energy Luxembourg S.A.R.L. (Canada Tax Court)

Satyam Computer Services Limited (now Tech Mahindra Limited) (Federal Court of Australia)

Taxability of income from software products and IT services in Australia



Facts

- Taxpayer had offices in Australia through which it provided software products and IT services to entities in Australia.
- Services performed partly by employees located in Australia and partly by employees located in India.

Issue

- Whether payments received for services provided by employees located in India that are "royalties" as per Article 12 of DTAA (but not "royalties" as defined in Australian domestic law) can be taken to have an Australian source for the purposes of Australian domestic law and, hence, an assessable income?

Satyam Computer Services Limited (now Tech Mahindra Limited) (Federal Court of Australia)

Taxability of income from software products and IT services in Australia

Income Tax Assessment Act 1997 (Cth) (ITAA 1997)

- **Section 6(5)(3) relevantly provides:**
  If you are a foreign resident, your assessable income includes:
  (a)the ordinary income you derived directly or indirectly from all Australian sources during the income year;
  (b).... .....
- **Section 995-1** – Ordinary income or statutory income has an Australian source if, and only if, it is derived from a source in Australia for the purposes of the Income Tax Assessment Acts .

International Tax Agreements Act 1953 (Cth) (Agreements Act)

- **Section 4(1)** – Subject to subsection (2), the Assessment Act is incorporated and shall be read as one with this Act.
- **Section 4(2)** – The provisions of this Act have effect notwithstanding anything inconsistent with those provisions contained in the Assessment Act (other than ....) or in an Act imposing Australian tax
- **Section 11Z** (until 27 June 2011) – Subject to this Act, on and after the date of entry into force of the DTAA, the provisions of the DTAA, so far as those provisions affect Australian tax, have the force of law according to their tenor.
- **Section 5** (replaces 11Z) – DTAA has the force of law according to its tenor.

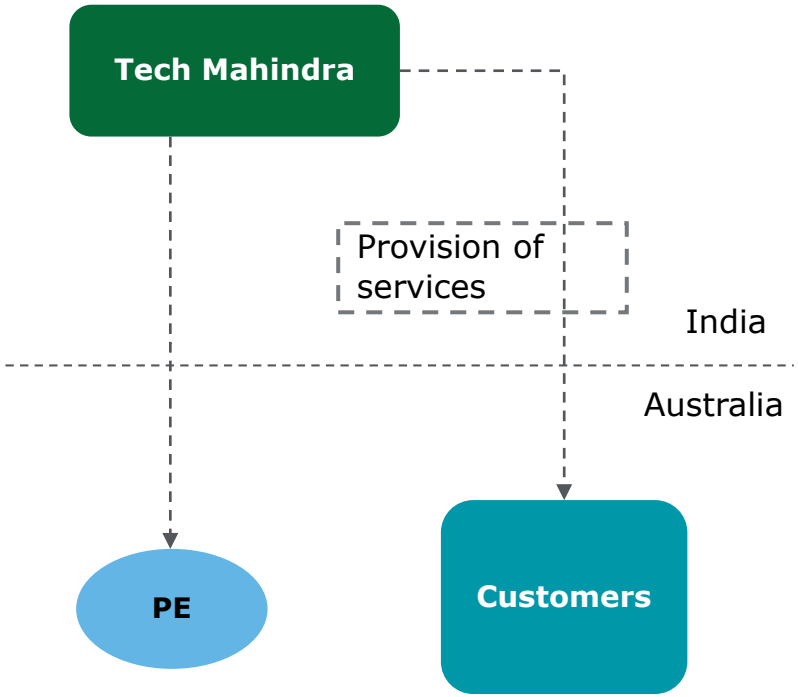
DTAA is a schedule to Agreements Act.

DTAA

- **Article 12 – Royalties**
  (2) Such royalties may also be taxed in the Contracting State in which they arise, ... but the tax so charged shall not exceed:
  (b) in the case of other royalties:
  (ii) during all subsequent years of income: 15 per cent of the gross amount of the royalties.
  (5) Royalties shall be deemed to arise in a Contracting State when the payer is .... a person who is a resident of that State for the purposes of its tax.
- **Article 23 – Source of income**
  (1) Income, profits or gains derived by a resident of one of the Contracting States which, under any one or more of Articles 6 to 8, Articles 10 to 20 and Article 22 may be taxed in the other Contracting State, shall for the purpose of the law of that other State relating to its tax, be deemed to be income from sources in that other State.

Satyam Computer Services Limited (now Tech Mahindra Limited) (Federal Court of Australia)

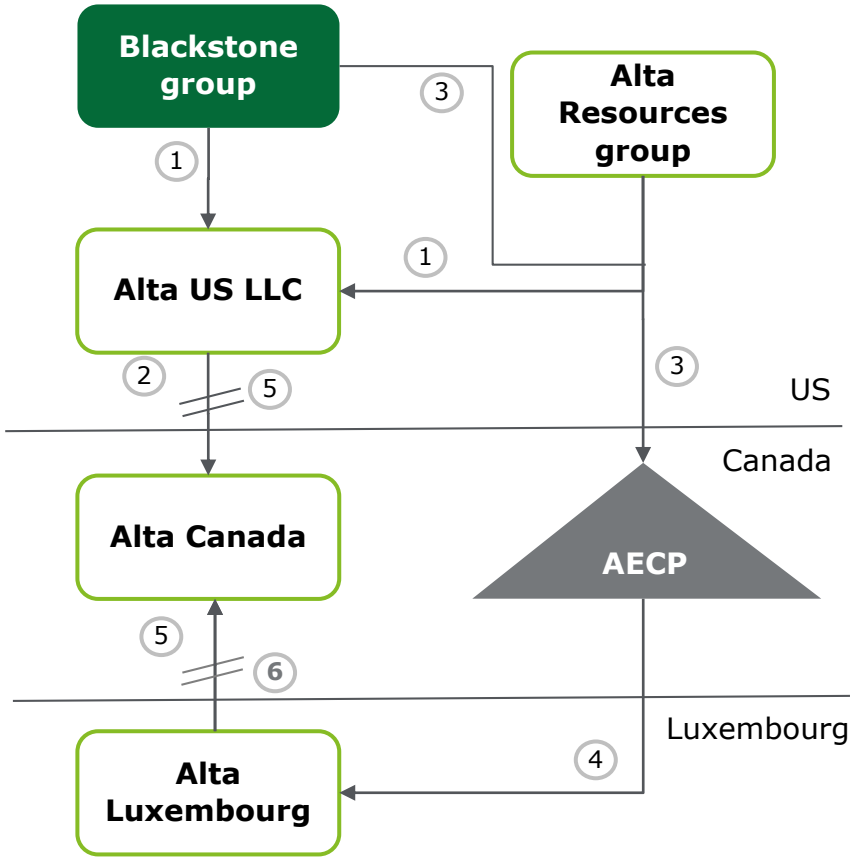
Taxability of income from software products and IT services in Australia



Findings

- Effect of Article 23 of DTAA is that payments are deemed to have an Australian source for purposes of section 6-5(3)(a).
- Effect of section 4(1) of Agreements Act is that both Agreements Act and Assessment Acts are to be interpreted and read as one.
  - Provisions of Agreements Act have effect and override provisions of Assessment Acts.
- Effect of section 4(2) of Agreements Act is that provisions of Article 23 of DTAA are the "leading" provisions and definition of "Australian source" in section 995-1 of ITAA 1997 is the "subordinate provision" which "must give way" to Article 23 of DTAA.
- Effect of section 5 of Agreements Act giving DTAA the force of law "according to its tenor" for Australian tax law purposes is to enact DTAA into Australian law with the result that deeming of source effected by Article 23 is given the force of law for Australian tax law purposes.
- Income has to be included in Tech Mahindra's assessable income under section 6-5(3)(a) of ITAA 1997 since it is income from an Australian source by reason of combined operation of Article 23 of DTAA, section 4 and 5 of Agreements Act and section 6-5(3)(a) of ITAA 1997.
- Further, double taxation also does not arise since by Article 23(2), reference to "income from sources within Australia" in Article 24(4)(a) encompasses income deemed to be income from sources in Australia by operation of Article 23(1).

Alta Energy Luxembourg S.A.R.L. (Canada Tax Court)

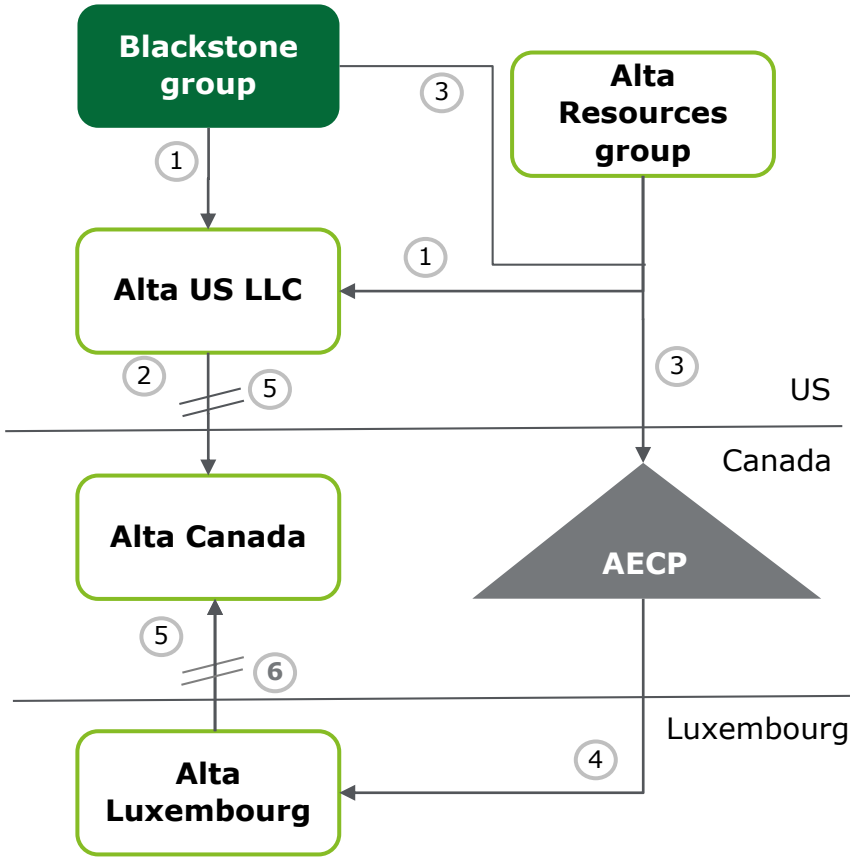


1. Blackstone group and Alta Resources group incorporate Alta US LLC
2. Alta US LLC incorporates Alta Canada
3. Blackstone group and Alta Resources group form AECP
4. AECP incorporates Alta Luxembourg
5. Alta Luxembourg acquires shares of Alta Canada from Alta US LLC
6. Alta Luxembourg transfers shares of Alta Canada

Facts

- Blackstone Group LP and Alta Resources LLC had formed Alta Energy Partners LLC (**Alta US LLC**), a Delaware limited liability corporation, to acquire and develop unconventional oil and natural gas properties in North America.
- In June 2011, Alta US LLC incorporated a wholly owned Canadian subsidiary Alta Energy Partners Canada (**Alta Canada**) to carry on Canadian business.
- Alta Canada carried on an unconventional shale oil business in Duvernay shale oil formation (**Duvernay Formation**) situated in Northern Alberta, Canada.
- It was granted the right to explore, drill and extract hydrocarbons from an area of that formation (**Alta Canada's Working Interest**) designated under licenses granted by the government of Alberta.
- Co-investors in Alta US LLC decided to revise the initial holding structure (through US) to mitigate US anti-deferral provisions.
- In absence of restructuring, partners of Alta Canada could have been subject to tax on their pro-rata share of certain categories of passive income.

Alta Energy Luxembourg S.A.R.L. (Canada Tax Court)



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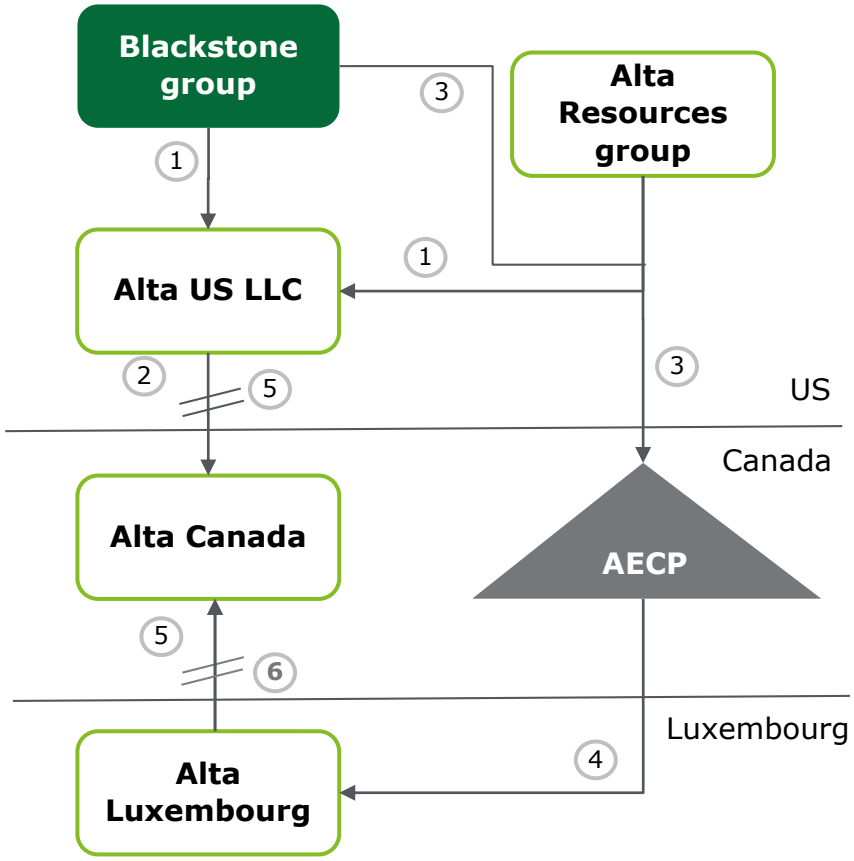
Facts

- **Restructuration**
  In April 2012:
  - Blackstone group and Alta Resources group formed a partnership Alta Energy Canada Partnership (AECP) under the laws of Alberta;
  - Alta Energy Luxembourg S.A.R.L. (Alta Luxembourg) was incorporated under the laws of Luxembourg with AECP as its sole shareholder;
  - Alta Luxembourg acquired certain common shares of Alta Canada from Alta US LLC, pursuant to restructuration of activities.
- In September 2013, Alta Luxembourg transferred its shares in Alta Canada (the Shares) to Chevron Canada Ltd.
- Alta Luxembourg claimed exemption from capital gains tax as per Article 13(5) of Canada-Luxembourg Income Tax Convention 1999 (Treaty).

Issue

Whether general anti-avoidance rule (GAAR) provided for in section 245 of the Canadian Income Tax Act (CITA) applies to deny the benefit of capital gains exemption claimed by Alta Luxembourg?

Alta Energy Luxembourg S.A.R.L. (Canada Tax Court)



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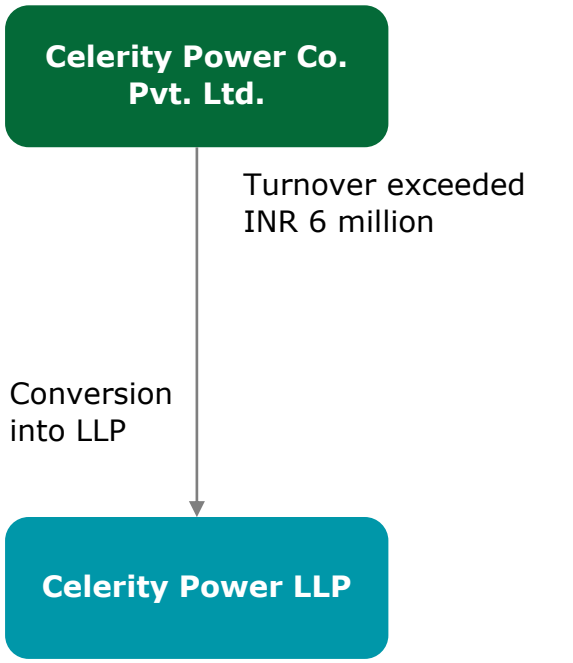
Findings

- Alta Canada's Working Interest in Duvernay Formation was "Excluded Property" for the purpose of Article 13(4) of the Treaty, thus capital gain realized on disposition of the Shares was not taxable as per the Treaty.
- **On the issue of conduit, Court held that by assessing the capital gains in hands of Alta Luxembourg, Revenue has accepted it to be the beneficial owner of the shares. Else, revenue should have made the assessment in hands of the actual beneficial owners itself.**
- **There is nothing in the Treaty that suggests that:**
  - a single purpose holding corporation, resident in Luxembourg, cannot avail itself of the benefits of the Treaty;
  - **a holding corporation, resident in Luxembourg, should be denied benefit of the Treaty because its shareholders are not themselves residents of Luxembourg.**
- Alta Luxembourg made significant investments in Duvernay Formation and thus, GAAR does not apply to preclude Alta Luxembourg from claiming the exemption as per Article 13(5) of the Treaty.
- Even though Alta Luxembourg had accepted that it derived a tax benefit from the Restructuring, the Court held that the Restructuring did not amount to a misuse or abuse of the provisions of the CITA or the Treaty.

Conversion of company to LLP

- Celerity Power LLP [2018] 100 taxmann.com 129 (Mumbai - Trib.)

Celerity Power LLP [2018] 100 taxmann.com 129 (Mumbai - Trib.)



Claim:

- capital gains to be exempt
- set-off of brought forward losses & unabsorbed depreciation

Facts

- Celerity Power LLP (CP LLP), a Limited Liability Partnership (LLP) was engaged in the business of power generation in AY 2011-12.
- CP LLP was earlier a company which converted into an LLP in September 2010 and the entire business, assets and liabilities of the said company were transferred to CP LLP.
- CP LLP claimed that the conversion into LLP did not involve any 'transfer' of property/assets. Alternatively, CPLLP also claimed that capital gains, if any, could only be brought to tax in the hands of the erstwhile company.
- CP LLP also claimed set-off of brought forward losses of INR 5,79,93,084 of the company against its income for AY 2011-12.
- The Tax Officer (TO) denied exemption from capital gains as well as denied the set-off of brought forward losses and unabsorbed depreciation.
- Commissioner of Income Tax (Appeals) [CIT(A)] upheld the order of TO.

Celerity Power LLP [2018] 100 taxmann.com 129 (Mumbai - Trib.)

Ruling of Tribunal

Whether conversion of company into LLP results in transfer of property?

- Per definition of 'convert' in clause 1(b) of 'Third Schedule' to Limited Liability Partnership Act, 2008 (LLP Act), the conversion of a company into a LLP involves transfer of property.
- Judgment of Bombay HC, in **Texspin Engg. & Mfg. Works [2003] 263 ITR 345, distinguished** because it related to conversion of a partnership into a company and not *vice-a-versa.*
- Where conditions prescribed in section 47(xiiib) of the Income-tax Act, 1961 (the ITA) are not fulfilled, **transfer of capital assets on conversion will be taxable.**
- Capital gains to be **taxable in the hands of LLP as a 'successor entity'**.

How to compute capital gains?

- Assets and liabilities of the erstwhile company were vested in the LLP at their 'book values'.
- Such **'book value' could only be regarded as the 'full value of consideration'** for the purpose of computation of 'capital gains'.
- Difference between the transfer value and the cost of acquisition was Nil, therefore, while computing the capital gains the machinery provision was rendered as unworkable.

Whether brought forward losses and unabsorbed depreciation is allowed to be set-off by LLP?

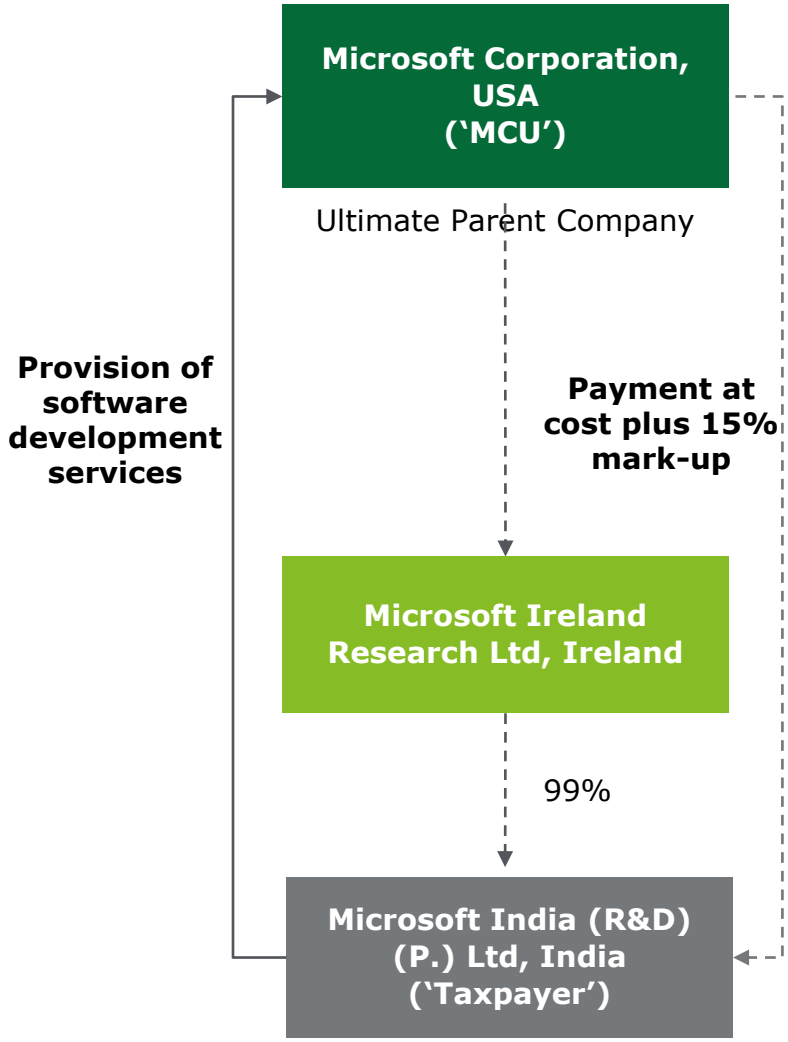
- Compliance with all the conditions prescribed in the proviso to section 47(xiii) of the Act is a precondition for allowance of set-off of brought forward losses of company.
- Sec. 58 of the Limited Liability Partnership Act, 2008 for vesting of all property of company into the LLP is only in context of the tangible and intangible property, interests, rights etc., and has nothing to do with the 'carry forward' of losses under the ITA.
- **Carry forward and set-off of losses and unabsorbed depreciation is not allowed to the LLP where conditions of section 47(xiiib) of the ITA are not fulfilled**.

Research and Development Services / Expenses

- Microsoft India (R&D) (P.) Ltd. [2018] 97 taxmann.com 360 (Delhi - Trib.)
- Koninklijke Philips Electronics N.V. [2018] 99 taxmann.com 23 (Kolkata - Trib.)

Microsoft India (R&D) (P.) Ltd (Delhi Tribunal)

Whether software development undertaken was routine or high-end software services involving R&D



Facts

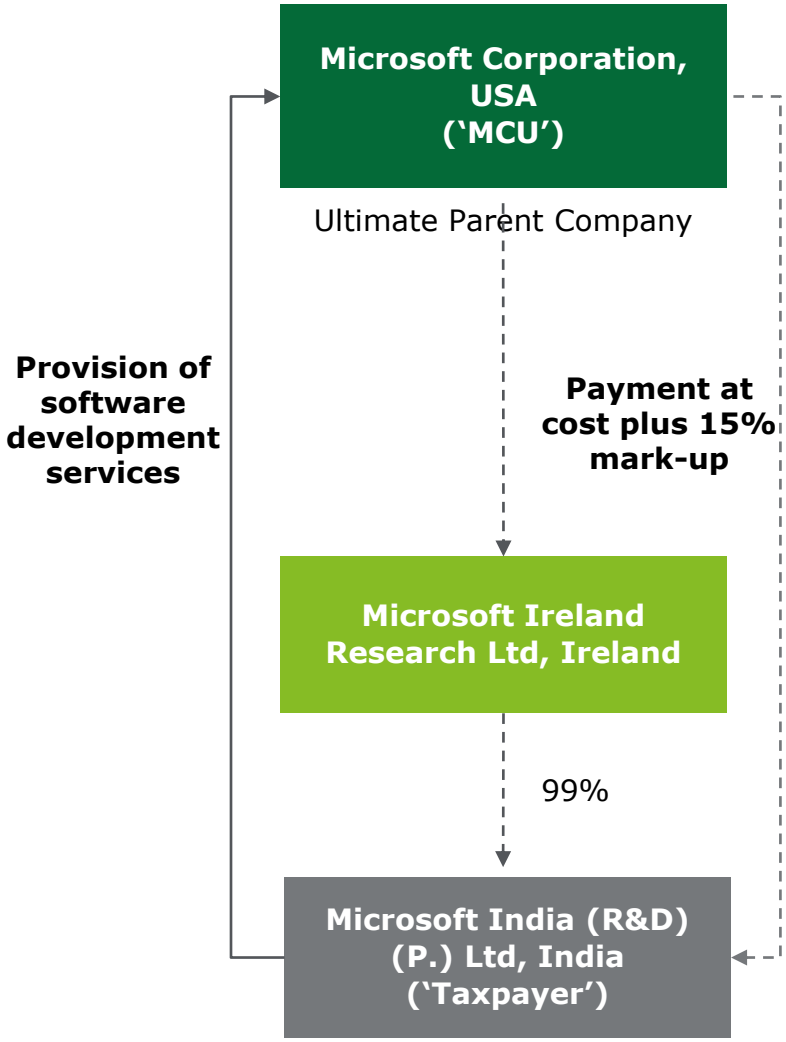
- Taxpayer was engaged in rendering software development services to Microsoft Corporation, USA (MCU) at cost plus 15% mark up.
- The transfer pricing officer took a view that the taxpayer was not a routine software developer, but was engaged in rendering high quality software engineering services and, accordingly, made a transfer pricing adjustment by holding that cost plus 15% mark up is not Arm's Length Price (ALP).

Issue

- Determination of nature of software development services undertaken by taxpayer for the purpose of determining ALP.

Microsoft India (R&D) (P.) Ltd (Delhi Tribunal)

Whether software development undertaken was routine or high-end software services involving R&D

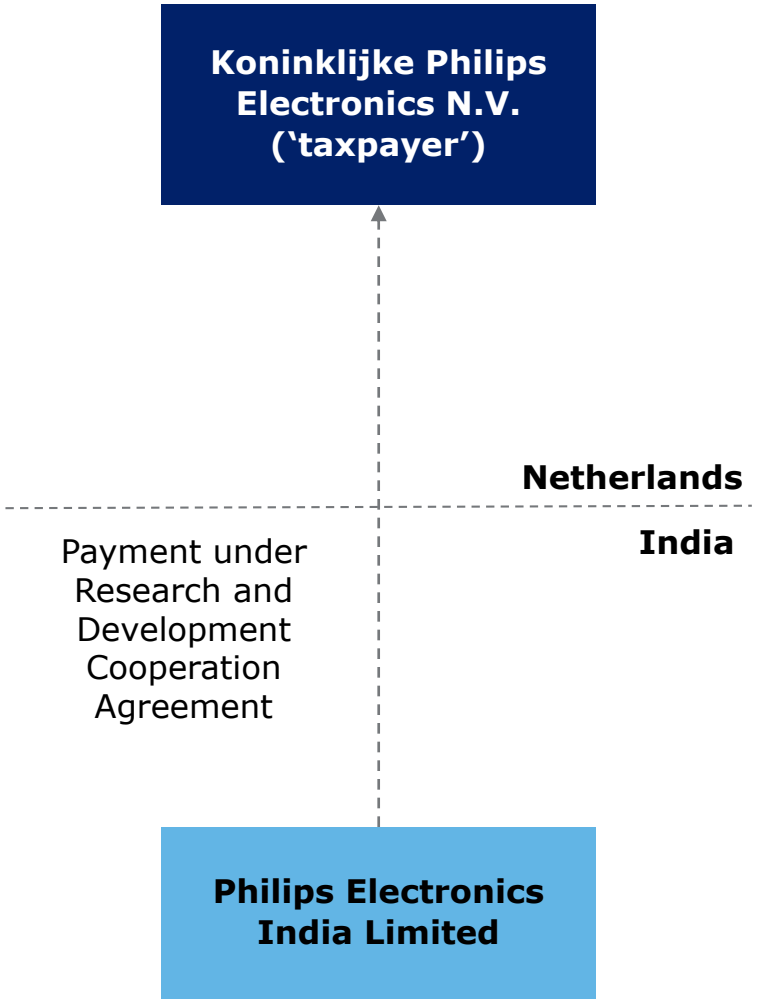


Findings

- The Tribunal made following key observations based on the Parent – Subsidiary Agreement (PSA) and other facts on record:
  - Taxpayer agreed to undertake R&D work and the scope of work was not restricted to developing / testing codes, but 'complete the project'.
  - IPR / output of the performance of such R&D work done by taxpayer will be owned by MCU.
  - Even though the R&D work undertaken was not for the entire product, but merely part of the overall product, it did not mean work undertaken by taxpayer ceases to be 'research'.
- Conduct of R&D activities was further substantiated by the fact that 113 patents were registered in USA for work done in India.
- Mere fact that taxpayer was compensated at 15% mark-up irrespective of outcome was manner of quantification of compensation and does not determine nature of work undertaken.
- Taking a holistic view of the matter, Tribunal held that taxpayer is engaged in providing R&D software services to MCI and cannot be regarded as routine software developer.

Koninklijke Philips Electronics N.V. (Kolkata Tribunal)

Research and Development expenses



Facts

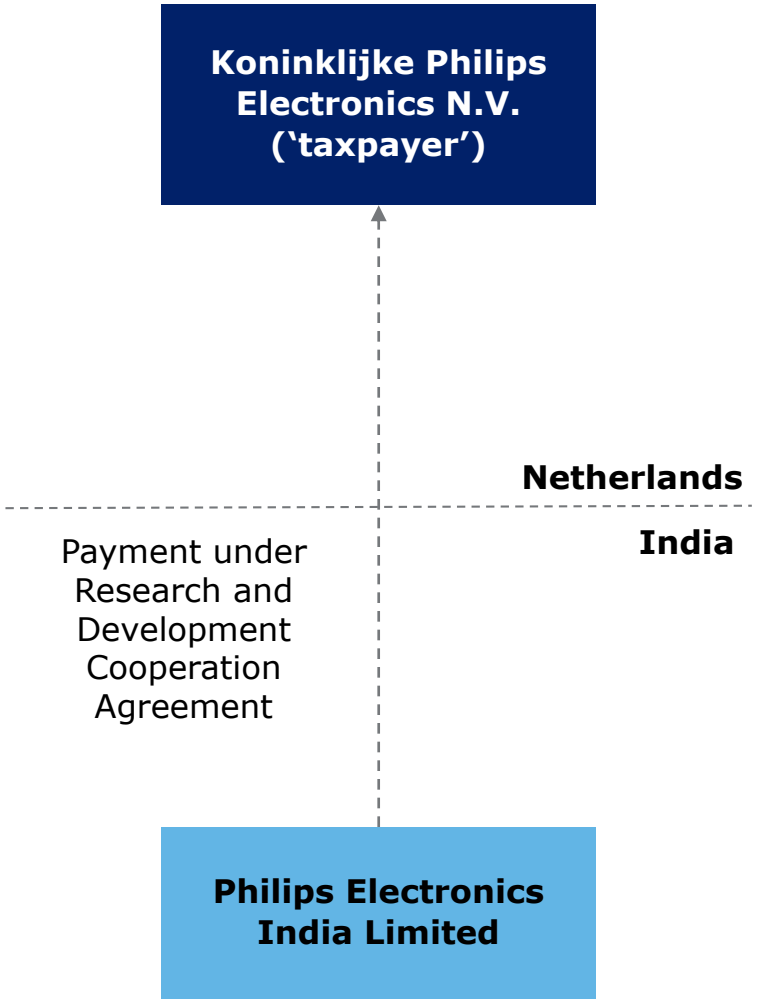
- Taxpayer entered into Research and Development Cooperation Agreement (RDCA) and Management Support Services Agreement (MSSA) with Indian company.
- Till AY 2007-08, taxpayer offered payments from RDCA and MSSA as taxable income under Royalty / FTS.
- Taxpayer revised its tax return for AY 2008-09 and first time adopted a new stand that payments received under RDCA and MSSA are reimbursements and not taxable in India as Royalty / FTS, relying on the case of ABB Ltd.

Issue

- Whether payments received by the taxpayer could be regarded as remuneration chargeable to tax or reimbursement not subject to tax in India?

Koninklijke Philips Electronics N.V. (Kolkata Tribunal)

Research and Development expenses



Findings

- R&D services provided to various group companies were essential for their functioning and included:
  - providing access to various benefits and information of such R&D; and
  - grant non-exclusive, non-transferable, and indivisible license for applying the aforesaid benefits and information.
- The cost of such R&D activities was reimbursed by taxpayer and, hence, the RDCA was nothing but a cost sharing agreement.
- The taxpayer merely provides various types of information and results of R&D activities.
- It did not impart any information concerning technical, industrial, commercial or scientific knowledge, experience or skill.
- Accordingly, in any event, the Tribunal held that the receipt for R&D activities would not be taxed as royalty under Article 12 of the DTAA.
- Tribunal also concluded that there is no estoppel against the law and taxpayer is entitled to offer income which is rightfully chargeable to income-tax.

Indirect Tax

- GST notification, press release and circular
- Important judicial precedents
- GST Advance Rulings - evolving jurisprudence

GST notification, press release and circular

GST Rate Rationalisation: 31st GST Council Meeting held on 22 December 2018

- Entertainment Industry granted a major relief as GST rates have been reduced on movie tickets above INR 100 (from 28 percent to 18 percent) and up to INR 100 (from 18 percent to 12 percent).
- Rates on 23 items from 18 percent to 12 percent and 5 percent.
- Many items including television, computers and various auto parts will be cheaper now.
- Certain agricultural goods in the 5 percent bracket have been moved to 0 percent.
- General insurance industry also welcome the rate reduction on third party insurance on goods carriage (from 18 percent to 12 percent).
- In view of contradictory advance rulings, GST rate has been rationalized for EPC contracts for solar power plants.
  - 70 percent of gross value of contract shall be the deemed value of goods supplied while balance shall be deemed value of services supplied
- Reverse charge has been re-introduced, in line with service tax regime, on security services received by a registered person from a non-body corporate service provider.
- Financial services sector have been impacted by rate rationalisation:
  - Services supplied by banks to Basic Saving Bank Deposit (BSBD) account holders under PradhanMantri Jan DhanYojana (PMJDY) exempted.
  - Services provided by unregistered business facilitator to a bank and agent of business correspondent to a business correspondent brought under reverse charge mechanism.

GST notification, press release and circular

Annual GST Returns and GST Audit: Strategic Extension

- Order issued on 31 December 2018 further extends the due date for filing of annual GST forms i.e. Annual GST returns and GST audit to 30 June 2019.
- Earlier vide gazette notification issued on 11 December 2018, due date for filing of annual GST returns and mandatory GST audit was extended from 31 December 2018 to 31 March 2019.

Proposed Amendments to Legislation to prune litigation

- Proposed Creation of a Centralised Appellate Authority for Advance Ruling has been proposed to deal with cases of conflicting decisions by two or more State Appellate Advance Ruling Authorities on the same issue.

Amnesty allowed for availment of input tax credit on lapsed invoices for FY 2017-18

- Order issued to permit availment of input tax credit on invoices pertaining to 2017-18 can be availed till the filing of GSTR 3B for March 2019, subject to conditions to be prescribed.

GST notification, press release and circular

GST return related proposals

- New return filing system based proposed to be introduced on trial basis from April 2019 and on mandatory basis from July 2019.
- Supply chain of goods now tagged with timely filing of GST returns. E-way not allowed to be generated on non-filing of GST returns for two consecutive tax period.

GST on services provided by del-credere agent (DCA)

- Central Board of Indirect Taxes and Customs (CBIC) clarifies Scope of Principal and Agent Relationship in circular issued on 73/47/2018-GST.
- Clarified that interest being charged by the DCA would not form part of the value of supply of goods supplied (to the buyer) by the supplier.

Important judicial precedents

Limitation on Power of the Department to reject the value declared at the time of importation under Customs law

Honourable Supreme Court held that the power of the department to reject the declared value is limited by the provisions of Customs Valuation Rules and is not unlimited. An important reaffirmation of the legal principle underlying the customs valuation mechanism and may be crucial to note in our interaction with the department. In essence, the burden is on the department to lead evidence for displacing the declared value in the absence of which Section 14 of the Customs Act does not permit the department to reject the declared value.

Sanjivani Non-Ferrous Trading Pvt. Ltd. [Judgment dated 10 December 2018]

Taxability under GST on goods sold to Duty Free Shops

Honourable High Court of Madhya Pradesh held that as the supply to a Duty Free Shops (DFS) by an Indian supplier is not to 'a place outside India', therefore, such supplies do not qualify as 'export of goods' under GST. Held that the concessions / exemptions granted earlier during the pre-GST regime cannot be claimed as a matter of right and petitioner is liable to pay GST on supply of indigenous goods to DFS.

Vasu Clothing Pvt. Ltd. [2018-VIL-577-MP]

GST Advance Rulings - evolving jurisprudence

GST on back office support services

Back office support services provided by the applicant to overseas clients held to be in the nature of intermediary services. Services provided by the Applicant involved co-ordination, arrangement of documentation, processing of payments. Ruling in case of M/s. Godaddy India Web Services Pvt Ltd distinguished on ground of facts.

Vserve Global Pvt. Ltd. [GST-ARA-03/2018-19/B-59]

GST on additional/delayed interest or penal charges

Applicant, a non banking financial company (NBFC), filed an application for advance ruling on applicability of GST on penal/default interest. Appellant. Ruling held that penal/default interest is in the nature of consideration and not subject to exemption as provided on interest on loan transactions. It was held that GST is applicable on such penal/default interest.

Bajaj Finance Ltd. [TS-TS-668-AAR-2018-NT-Bajaj Finance]

GST on Inter-office services

Applicant moved before Appellate Authority of Advance ruling on the issue of taxability of activities performed by the employees at the Corporate Office in the course of or in relation to employment, for the units located in the other States. Held that GST is applicable by virtue of the entry 2 of Schedule I, supply of services between distinct persons even if without consideration is a "supply”.

M/s Columbia Asia Hospitals Pvt. Ltd. [2018-VIL-30-AAAR]

GST Advance Rulings - evolving jurisprudence

Taxability of canteen services to employees

Advance ruling in context of applicability of GST on recovery of food expenses from employees for canteen services provided by the Applicant. Judgment of Honourable High Court for pre-GST period in case of applicability of VAT on food supplied to workers referred. Ruling held that GST is applicable on recovery of food expenses.

Caltech Polymers Pvt Ltd [TS-584-AAAR-2018-NT-Caltech Polymers Pvt Ltd]

Advance ruling on e-commerce transactions

Appeal filed before the Karnataka Appellate authority on ruling held by advance ruling authority. Application filed by an information technology platform service provider for booking of cabs. Issue involved is whether the applicant can be held as an e-commerce operator wherein it provides IT platform including mobile app and website for connecting customers and taxi drivers.

Opta Cabs Private Limited [2018-VIL-26-AAR]

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