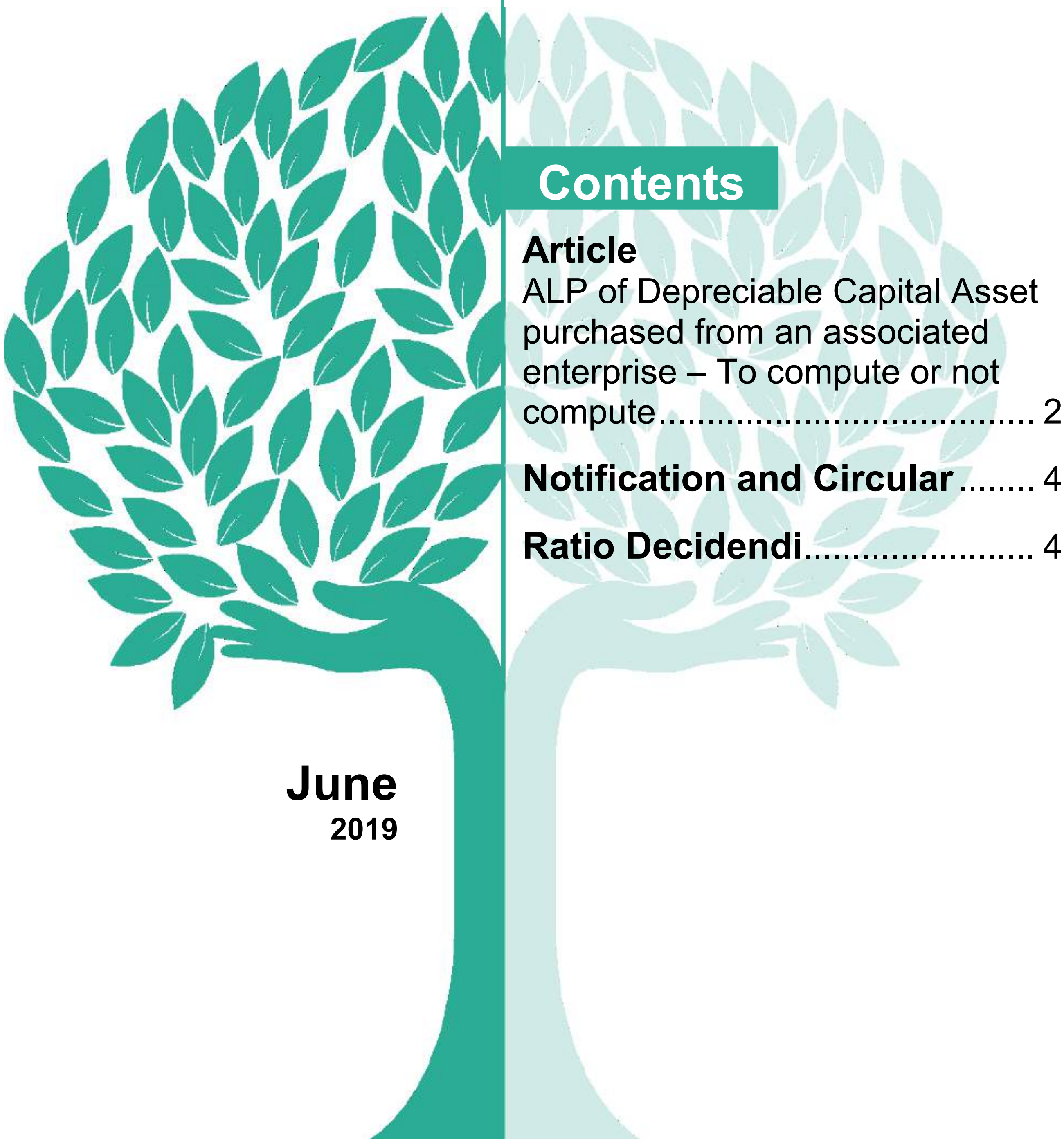
Lakshmikumaran & Sridharan attorneys

Direct Tax

amicus

An e-newsletter from **Lakshmikumaran & Sridharan**, India

June 2019 / Issue–57



Contents

June
2019

Article

ALP of Depreciable Capital Asset purchased from an associated enterprise – To compute or not compute

By **Sriram Vijayaraghavan**

The question of applicability of Chapter X ("transfer pricing provisions") of Income Tax Act, 1961 ("IT Act") with respect to issue of shares had come up in the past and in the *Vodafone judgment*[1], it was held that transfer pricing provisions kick in only when an income is charged to tax under other provisions of the IT Act.

In this background, whether transfer pricing ("TP") provisions apply when depreciable capital assets are purchased from associated enterprises ("AE") is a question that has to be answered in a fact specific manner. Similarly, whether arm's length price ("ALP") needs to be computed for every purchase of depreciable capital assets between AEs also needs to be answered keeping the facts in consideration.

Why the question?

Suppose an Indian company ("I. Co.") purchases depreciable capital assets from its AE being a foreign company ("F. Co.") for ₹100,000/-, is I. Co. as an assessee obligated to compute ALP for this transaction?

It is a well settled law[2] that in its normal meaning 'income' will not include capital receipts unless it is so specified in Section 2(24) of the IT Act. Neither Section 2(24)(vi) read with Section 45 nor clauses (vii), (ix) and (x) of sub-section (2) of Section 56 define purchase of depreciable capital assets to be income. Hence such a question arises.

Case law dealing with such a situation

The ITAT judgment in the *Honda Motorcycles & Scooters India (P) Ltd v. ACIT, Circle-1(1), Gurgaon*[3] ("*Honda Motorcycle* case") dealt with the above question. This judgment held that:

- According to the Explanation to sub-section (2) of Section 92B, a transaction of purchase of fixed asset is also an international transaction.
- Since Section 92 is not a charging section but a procedural provision for re-computing the income, there must be some existing income chargeable to tax before applying TP provisions.
- If there is an international transaction in the capital field not giving rise to any income in itself then, no adjustment can be made for the difference between the declared value and the ALP of such international transaction.
- Computation of ALP is necessary because of the impact of such a transaction on the revenue offshoots, i.e. depreciation charge which goes into the computation of income. In such cases, depreciation must be based on the ALP of such assets.

Does that mean all capital asset purchase transactions require ALP computation?

The jurisprudence on this question has not developed yet. The answer to this question is also very fact specific. In the case of block of assets, Section 32 allows deduction of depreciation on the written down value, which is

[1] [2014] 50 taxmann.com 300

[2] Vodafone judgment (supra)

[3] [2015] 56 taxmann.com 237 (Delhi - Trib.)

defined in Section 43(6) with reference to the actual cost of assets as defined by Section 43(1).

An analysis of Section 43(1) will reveal that in specific instances, the explanations provide a deeming fiction to deem actual cost to be something other than the "actual cost". Illustrations of such deemed cost, are explanations 3, 4A, 6, 7 and so on.

It is settled principle of law that a deeming fiction must be construed strictly. Therefore, where actual cost is determined based on a deeming fiction computation of ALP would have no relevance.

Computation of ALP becomes relevant only where the actual cost is determined based on real cost to the assessee. This leads us to few more questions.

When does ALP have to be computed?

In instances where ALP computation becomes relevant, further questions may arise as to whether ALP computation must be done in the same year in which international transaction is entered into even though the depreciation claim may arise only in later years.

It follows from a reading of Section 92 of the IT Act with the *Vodafone judgment* and *Honda Motorcycle case* that re-computation of income with reference to ALP arises only when there exists an income chargeable to tax under some other provision of the IT Act. Since this includes allowance for deductions, the obligation to determine ALP in the case of purchase of depreciable capital asset arises only when depreciation is claimed.

However, this will not relieve the person from his or her obligation to maintain information as stipulated in Section 92D and the relevant rules of the Income Tax Rules, 1962 because Section 92D obliges a person who enters into an international transaction to maintain information in respect of such international transaction.

Should the ALP be used to adjust the value of assets or should it be used to adjust the depreciation charge?

According to the *Honda Motorcycle case*, no adjustment can be made for the difference between the declared value and the ALP as international transaction in the capital field not giving rise to any income in itself. In light of this, it is clear that only the value of depreciation charge claimed needs to be adjusted based on the ALP i.e. TP adjustment is the difference between depreciation computed on the actual purchase price of the depreciable capital asset and its ALP.

In instances where ALP computation is not relevant (deemed cost scenarios), what happens if the depreciable capital asset so purchased in the international transaction is sold or transferred later?

For instance, when a depreciable asset is transferred between a holding company and its wholly owned subsidiary, the actual cost in the hands of the transferee company will be taken as the written down value of the transferor company immediately prior to the transfer in terms of Explanation 6 to Section 43(1). As the depreciation claim of the transferee will not be based on the price at which these assets are purchased from the transferor (AE), the question of determining the ALP does not arise. Moreover, even at the time of subsequent sale or transfer of these assets by the transferee, capital gain will be computed based on the written down value and not based on the purchase price of the assets. Consequently, the requirement to compute ALP of the assets will not arise at that stage as well.

[The author is a Principal Associate, Direct Tax Team, Lakshmikumaran & Sridharan, Delhi]

Notification and Circular

Online submission of statement of deduction of tax

The procedures and formats for e-filing of statements of deduction of tax at source by deductors have been notified *vide* Notification No. 10/2019, dated 4-6-2019. Deductors will have the option of online filing of e-TDS and e-TCS returns. They are required to register at the e-filing portal of the department and may use Return Preparation Utility, the Statement and File Validation Utility for the same. The statement can be uploaded with Digital signature or deductor can use the Electronic Verification Code (EVC).

Allowability of set-off of losses against certain deemed income – Clarification for period prior to AY 2017-18

By way of Circular No. 11/2019, dated 19-6-2019, CBDT has clarified that set-off of brought forward losses against income which includes income under Section 68/69/69A/69B/69C/69D (pertaining to cash credits, unexplained investments etc.), is allowable till assessment year 2016-17. As per amendment to Section 115BBE in 2016 effective from 1-4-2017, no set-off of losses is permissible while computing tax on income under the sections mentioned above. Taking note of the fact that in certain assessments, such set-off was being allowed for the period prior to assessment year 2017-18, the Circular now clarifies that the same is in line with the legislative intent since the terms 'or set-off of any loss' was specifically inserted only by Finance Act, 2016 and effective from 1-4-2017.

Ratio Decidendi

Tax not leviable when there is no 'real income' or 'right to receive' payment

The assessee was engaged in construction work for a private company. Subsequent to the completion of the work, the engaging company went bankrupt and did not credit the bill amount to the account of the tax-payer and the ultimate collection of the said amount was uncertain. However, the department added this amount as income in the hands of tax-payer, because of the invoices raised and services rendered to the party, and on the ground that actual payment was not necessary as the assessee was following mercantile system of accounting. The High Court of Bombay, however, has held that mere raising of invoice is not akin to accrual of income, even in mercantile system of accounting. Thus, no real income accrued to assessee in respect of the contractual work. The Court also noted that some of these bills were raised after the termination of the contract, which were not even accepted by the contracted party. It was held that since the 'right to receive' never accrued to the assessee, it can not be subject to income tax. [*CIT* v. *Bechtel International Inc.* - TS-316-HC-2019 (BOM)]

Payments for lounge premises is not rent; Amount retained by a bank/credit card agency is not commission

The tax-payer Airlines Company provides lounge services at airport to few of its selected customers. These lounge premises are rented by an intermediary agency from Airport Authority. As per the arrangement between the agency and airline companies (in some cases credit card companies), lounge facility is given to the premier customers of the latter. In the instant case, the tax-payer had been deducting tax at source under Section 194C (on payment for performance under a contract). Department contended that the nature of this payment is that of rent, and that TDS ought to have been deducted under Section 194I. The Bombay High Court observed that the tax-payer paid a committed amount to the lounge agency on a lump sum basis, which did not depend on the customer flow, and the tax-payer did not have exclusive use to the premises for its customers. It was hence held that the lounge premises were not rented out by the tax-payer.

Additionally, the revenue contended that the amount of consideration retained by bank/credit card agency, at the time of flight booking, is "commission/brokerage" and is subject to TDS under Section 194H. It was held that there was only a 'principal-to-principal' relationship between the tax-payer (airline) and the banks/credit card agency, i.e. latter did not act as the agent of the former, and hence, payment does not amount to commission with the meaning of Section 194H of the Act. [*CIT* v. *Jet Airways (India)Ltd.* - TS-231-HC-2019 (BOM)]

'Referral Fees' paid to a US concern is not taxable under domestic Act or Indo-US DTAA

The tax-payer, an Indian company, was engaged in international real estate advisory and property management services. The US concern of the tax-payer was engaged in service of introducing clients to its Indian counterpart. The ITAT observed that the services in question do not "make available" any technical knowledge, experience, skill, know-how or processes to the tax-payer, and thus, does not amount to the provision of Fees for Included Services (FIS) under India-US DTAA. Further, with respect to the Income Tax Act, 1961, referral fee did not satisfy the criteria under Section 9(1)(vii) of the Act, which states that the service received is either managerial, technical or consultancy services, hence the same cannot be characterized as 'fees for technical services' (FTS). [*Knight Frank (India) Pvt. Ltd.* v. *ACIT* - TS-336-ITAT-2019 (Mum)]

TDS not applicable on service tax component of insurance commission to agents

At issue was the quantum on which TDS has to be deducted under Section 194H, for "commission" to insurance agents by the assessee, who was an insurer. The Bombay High Court observed that deduction of tax at source has to be from the payment of 'net insurance commission' to agents by tax-payer, after excluding the service tax component from gross commission. The Court observed that this is on account of the fact that the tax-payer pays only the net amount to the agent, after directly depositing the service tax component with the Government. It was held that since the service tax component is separately indicated, the same would not form part of the payment for deduction of tax at source. [*CIT* v. *Reliance Life Insurance Co. Ltd.* - TS-334-HC-2019 (BOM)]

Income accrues in the year in which it is received and cannot be deferred over the period of time as agreed in the contract

The tax-payer was engaged in the business of procession, preservation and storage of blood stem cells. The department sought to tax the entire sum of money received towards the storage of stem cells for a period of 21 years on the ground that the amount is non-refundable, unless the specimen itself is unfit for processing or the agreement is terminated. Department further noted that the tax-payer had not deferred any expenditure in relation to the storage fee received but had deferred only the income and hence such an accounting treatment is against the basic accounting principles. The tax-payer claimed that the income should be spread over 21 years, being the agreed period of time as per the contract entered into with the clients. It was held that the tax-payer had acquired the right to receive the fee the moment they entered into a contract and received the fee. The income is said to have accrued at the moment the Appellant received the fee. Further, the Profit & Loss account of the tax-payer showed that expenditure incurred has not been apportioned for a period of 21 years (period of contract), whereas, only the income has been deferred leading to a distortion of the profit and loss. Therefore, it was held that the tax-payer is liable to discharge tax on the entire income received, and it cannot be deferred over the period of the contract. [*Lifecell International Pvt. Ltd.* v. *AC of IT, Chennai* – TS-312-ITAT-2019-CHNY]

NEW DELHI
5 Link Road, Jangpura Extension,
Opp. Jangpura Metro Station,
New Delhi 110014
Phone : +91-11-4129 9811

B-6/10, Safdarjung Enclave
New Delhi -110 029
Phone : +91-11-4129 9900
E-mail : lsdel@lakshmisri.com

MUMBAI
2nd floor, B&C Wing,
Cnergy IT Park, Appa Saheb Marathe Marg,
(Near Century Bazar)Prabhadevi,
Mumbai - 400025
Phone : +91-22-24392500
E-mail : lsbom@lakshmisri.com

CHENNAI
2, Wallace Garden, 2nd Street
Chennai - 600 006
Phone : +91-44-2833 4700
E-mail : lsmds@lakshmisri.com

BENGALURU
4th floor, World Trade Center
Brigade Gateway Campus
26/1, Dr. Rajkumar Road,
Malleswaram West, Bangalore-560 055.
Ph: +91(80) 49331800
Fax:+91(80) 49331899
E-mail : lsblr@lakshmisri.com

HYDERABAD
'Hastigiri', 5-9-163, Chapel Road
Opp. Methodist Church,
Nampally
Hyderabad - 500 001
Phone : +91-40-2323 4924
E-mail :lshyd@lakshmisri.com

AHMEDABAD
B-334, SAKAR-VII,
Nehru Bridge Corner, Ashram Road,
Ahmedabad - 380 009
Phone : +91-79-4001 4500
E-mail : lsahd@lakshmisri.com

PUNE
607-609, Nucleus, 1 Church Road,
Camp, Pune-411 001.
Phone : +91-20-6680 1900
E-mail :lspune@lakshmisri.com

KOLKATA
2nd Floor, Kanak Building
41, Chowringhee Road,
Kolkatta-700071
Phone : +91-33-4005 5570
E-mail : lskolkata@lakshmisri.com

CHANDIGARH
1st Floor, SCO No. 59,
Sector 26,
Chandigarh -160026
Phone : +91-172-4921700
E-mail :lschd@lakshmisri.com

GURGAON
OS2 & OS3, 5th floor,
Corporate Office Tower,
Ambience Island,
Sector 25-A,
Gurgaon-122001
phone: +91-0124 - 477 1300
Email: lsgurgaon@lakshmisri.com

ALLAHABAD
3/1A/3, (opposite Auto Sales),
Colvin Road, (Lohia Marg),
Allahabad -211001 (U.R)
phone . +91-0532 - 2421037, 2420359
Email:lsallahabad@lakshmisri.com