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Article

Tax bonanza for Telecom companies?

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Background

Honourable Delhi High Court in a recent decision[1] has held that the deduction under Section 80-IA(2A) for telecommunication companies is also available with respect to various ancillary income such as liquidated damages, interest, sale of directories and extra-ordinary items of income. The High Court interpreted Sub-section (2A) as a stand-alone provision and held that the narrow phrase 'derived from' present in Sub-section (1) cannot be imported therein. This article seeks to analyse the provisions under consideration and evaluate as to how the taxpayers should position themselves in the light of this decision.

Legislative framework governing the issue

From a plain reading of Section 80-IA, following points can be noticed:

a) Sub-section (1) is the main provision granting deduction and provides as under:

- A deduction of an amount equal to hundred per cent of the profits and gains is available from Gross Total Income
- Such deduction is available for ten consecutive Assessment Years
- The deduction shall be allowed in accordance with and subject to the provisions of this section
- The business eligible for the deduction are as per Sub-section (4)

b) Sub-section (4) of Section 80A specifies following businesses (broadly)

- Infrastructure facility
- Telecommunication services
- Development etc., of industrial park or Special Economic Zone
- Power generation
- Laying and operating a cross-country natural gas distribution network

c) Sub-section (2) of Section 80-IA deals with infrastructure and telecom companies in following terms:

- This Sub-section gives an option to the assessee
- The option is to claim deduction for any ten consecutive assessment years out of fifteen years
- Fifteen year window begins from the year in which the undertaking or the enterprise
  - develops and begins to operate any infrastructure facility
  - starts providing telecommunication service
  - develops an industrial park
  - develops a special economic zone referred to in clause (iii) of Sub-section (4)
  - generates power or commences transmission or distribution of power or undertakes substantial renovation

[1] *Pr. CIT v. BSNL ITA 476-479/2016 & 81-483/2016* dated 1 August 2016

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and modernisation of the existing transmission or distribution lines or lays and begins to operate a cross-country natural gas distribution network

d) Sub-section (2A) deals with deduction available to telecommunication service provider

- This sub-section starts with non-obstante clause and overrides sub-section (1) and (2)
- It pertains only to deduction from total income of an undertaking providing telecommunication services
- It provides two tier rates for the deduction (i.e. 100% for first five years and 30% thereafter for further five years)
- First five years to commence at any time during the periods as specified in sub-section (2)

The following table captures some of the areas where sub-sections (1), (2) & (2A) overlap and give rise to the issue before hand:

Subject	Sub-section (1)	Sub-section (2)	Sub-section (2A)
Eligible business	As per Sub-section (4)	Same as sub-section (4)	Only telecommunication services [as per clause (ii) of sub-section (4)
Percentage of profits eligible for deduction	100 %	Not discussed	Two tier rate 100% - first five years 30% - further five years
Period of deduction:			
Overall effective period of deduction	Ten consecutive years	Ten consecutive years	Five years plus further five years (in effect 10 years)
Commencement of tax holiday period	Not specified	From commencement of respective business	At any time during the periods as specified in sub-section (2)
Expiry of tax holiday period	Not specified	Fifteen years from commencement	Not specified

As is evident from the above, sub-section (2A) overlaps with sub-section (1) and (2) with respect to two factors namely, rate of tax holiday and period. While rate of tax holiday as per sub-section (1) is hundred percent for ten years for all eligible businesses, the rate

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for telecommunication business has been specifically curtailed by sub-section (2A). Further, as regards the period of tax holiday, the expiry of tax holiday period has been mentioned as fifteenth year in sub-section (2), while sub-section (2A) does not provide any such timeline.

Author's Interpretation of sub-section (2A)

The issue before the Court was whether the tax holiday as per sub-section (4)(ii) read with sub-section (2A) can be claimed for all kinds of income earned by the taxpayer or it needs to be derived from the relevant business.

The sustainability of such an extended claim has been analysed hereunder to ascertain whether sub-section (2A) being a non-obstante provision could override sub-section (1) on all aspects.

Sub-section (2A) has been reproduced hereunder for ease of reference:

"(2A) Notwithstanding anything contained in sub-section (1) or sub-section (2), *the deduction* in computing the total income of an undertaking providing telecommunication services, specified in clause (ii) of sub-section (4), *shall be hundred per cent of the profits and gains of the eligible business for the first five assessment years* commencing at any time during the periods as specified in sub-section (2) *and thereafter, thirty per cent* of such profits and gains for further five assessment years." [emphasis supplied]

For appreciating the true import and effect of a provision with non-obstante clause useful reference can be made to following judicial precedents:

- *Union of India* v. *G. M. Kokil*, AIR [1984] SC 1022 (SC)

"A non obstante clause is a legislative device which is usually employed *to give overriding effect* to certain provisions *over some contrary provisions* that may be found either in the same enactment or some other enactment; that is to say *to avoid the operation and effect of all contrary provisions*"

Close observation of above would reveal that the overriding effect of non-obstante clause may have a very limited implication i.e. only with respect to contradicting provisions. Thus it would not have effect in the absence of an 'inconsistency' in the two provisions. The following ruling of Hon'ble Supreme Court is worth noting in this regard:

- *R. S. Raghunath* vs *State Of Karnataka And Another* [1992] 79 AIR 81 [SC (3JB)]

"13. As already noted, there should be a *clear inconsistency* between the two enactments before giving an overriding effect to the non obstante clause but when the scope of the provisions of an earlier enactment is clear the same cannot be cut down by resort to non-obstante clause."

Based on the above decision it can be concluded that *as regards the profits eligible for deduction*, the same continue to be governed by sub-section (1) even in case of telecom companies because *sub-section (2A)* despite being non-obstante in nature, *falls short of providing anything contrary to sub-section (1)*.

This view can further be supported by

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another argument. One may notice that the expression used in the opening phrase of this sub-section is 'the deduction' and not 'deduction'. *That expression can be reasonably understood as referring to the expression earlier used in the provision,* thus it can be understood as referring to the deduction previously talked about i.e. deduction referred to in sub-section (1) and (2) [2]. The deduction referred to in sub-section (1) is based on profits derived by industrial undertaking from an eligible business. Sub-section (2A) uses the expression *'profits and gains of the eligible business'* which does not create any clear departure from sub-section (1) rather needs to be interpreted harmoniously therewith.

Another interesting issue that emerges on this interpretation is that the period of deduction referred to in sub-section (2A) makes a clear departure from previous sub-sections. It clearly mentions that total period consists of two sets of five years wherein the first set needs to commence within the overall window of fifteen years. This would mean that the overall window of deduction can be as long as 24 years from the initial year[3].

Conclusion

The decisions of Apex court in the case of *RS Raghunath* and *Vegetable Products* (supra) were apparently not cited before the Hon'ble Delhi High Court. It is therefore doubtful whether the decision would have been the same even after referring to these binding precedents. Considering this, it is likely that the decision of Hon'ble Delhi High Court might not get affirmed by Apex Court in further appeal. Taxpayers thus should be conscious of this while discharging their tax liability. Further, taxpayers can take a relook at their total eligible period in case a part of the ten years period falls outside the 15 year window provided in sub-section (2).

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Notifications and Circulars

The Taxation Laws (Amendment) Bill, 2016

On 10th August, 2016, Lok Sabha cleared The Tax Laws (Amendment) Bill, 2016 (Bill No. 215 of 2016) proposing to make following amendments to the Income Tax Act, 1961:

1) *Reduction of period of employment in section 80JJA to 150 days for assesse manufacturing apparels:* Section 80JJA entitles the assessee to claim a deduction of 30% on the additional wages to the new regular workmen employed by the assessee. One of the conditions to be satisfied for availing the deductions is that the workmen must be employed for a period of 240 days during the year. However, owing to seasonal nature of the business of manufacturing apparels, the threshold period of retention of new workmen has been reduced to 150 days

2 For this proposition reliance can be placed on the decision of Apex Court in the case of CIT v Vegetable Products 88 ITR 192 (SC)(3JB)

3 Assuming that the first set of five years starts during 15th year as counted from initial year

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for the assesses engaged in the business of manufacturing apparels.

2) *Explanation 5 to section 2(19AA) of the Income Tax Act, 1961:* Section 2(19AA) of the Income Tax Act, 1961 defines demerger. Explanation 5 has been inserted to this section to provide that the reconstruction or splitting up of a company, which ceased to be a public sector company as a result of transfer of its shares by the Central Government, into separate companies, shall be deemed to be a demerger, if such reconstruction or splitting up has been made to give effect to any condition attached to the said transfer of shares and also fulfills such other conditions as may be notified by the central Government in the Official Gazette

Clarifications regarding Income Declaration Scheme and notification of new dates for payment of amounts due

Circular No. 29/2016 dated 18-8-2016 issued in continuance of Circular 27/2016 clarifies *inter-alia* the following issues:

- The declarations can be filed for fictitious liabilities
- Income declared for an earlier assessment year can be taken into account to explain the transactions of subsequent assessment year in the assessment proceedings provided there is a nexus between the income declared and the transactions of the subsequent assessment year
- Period of holding of asset declared under the Scheme shall be based on the actual date of acquisition of such asset. However, the indexation benefit in respect of the assets declared under the scheme shall be available from 1-6-2016 only.

By Notification No. 59/2016 dated 20-7-2016, CBDT has notified the following dates for making payment in relation to incomes declared as per the Income Declaration Scheme, 2016:

(i) 30th November, 2016: 25% of tax, surcharge and penalty

(ii) 31st March 2017: 50% of tax, surcharge and penalty

(iii) 30th September 2017: 100% of tax surcharge and penalty

Earlier, as per Notification 32/2016 dated 19-5-2016 taxes on income declared under the income declaration scheme were required to be paid by 30-9-2016.

Ratio decidendi

ALP for import of second-hand machinery

Taxpayer had imported some used machinery from its AE in UK. For supporting that the transaction price is at ALP it relied on a valuation certificate issued by an independent chartered engineer. It also provided a quotation from manufacturer of similar machines to show that new machine of similar nature and capacity etc. costs much higher while the quality and quantity of output by the old machine was not significantly different. TPO observed that the

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chartered engineer certificate was based only on visual observation and no technical test of the output of the machine was carried out. It also noted that the book value of machine in the hands of AE was GBP 84155 while it was sold to taxpayer at GBP 201800. TPO therefore applied CUP method by referring to the operating margins of companies manufacturing similar machines. Rejecting the contentions of TPO and relying on decisions in the case of *Coastal Energy* (Chennai), *Tecumseh Products* (Hyd), *Koch chemicals* (Mum) and *Intel Asia* (Bang) it held that without referring to the matter to DVO it was not proper for TPO to reject the valuation certificate of chartered engineer. [*GKN Sinter Metals* v. *ACIT-71 Taxmann.com 297 (Pune – Trib)*]

CUP method followed by sole distributor - Change of method permissible

Taxpayer was engaged in the business of distribution of heavy earth moving machinery. It had adopted TNMM as most appropriate method in its TP Study. During TP audit it switched to CUP method and provided comparable prices for sales made by AE to independent distributors in other countries. The CIF price was adjusted to arrive at FOB value. Rejecting the contentions of revenue authorities, ITAT held that change of method is permissible as CUP is a better method. It further held that adjustment on account of geographical differences have to be made and substantiated by taxpayer. Remanding the issue, ITAT also cautioned that if at any stage the data furnished by taxpayer is found to be inadequate then TPO shall proceed to determine ALP as per other methods. Another issue was regarding import of plant and machinery whereon AE had charged 10% mark-up to cover its administrative and other expenses in the nature of warehousing and logistics. ITAT rejecting the contention of taxpayer observed that the basis is devoid of merit and evidentiary value. [*Liugong India Private Ltd.* v. *ACIT ITA-1482/Del/2015*]

ALP consideration is not required for issuing Letter of Comfort in favour of AE

Taxpayer issued a letter of comfort in favour of one of its subsidiaries so as to enable the latter to avail loan from banks on favourable terms. TPO observed that issuing such letter exposes the taxpayer to a risk of repaying the loan in case of default committed by the AE. Taxpayer however contended that it did not incur any cost for issuing the letter of comfort hence the same should not be treated as an international transaction. ITAT agreed to the presence of risk element as argued by revenue authorities however rejected the contention of treating it as an international transaction. It agreed with taxpayer and held that in the absence of any cost having been incurred, the transaction cannot be subjected to rigours of Transfer Pricing. Taxpayer on the same lines had argued that interest free loan granted to another AE was out of interest free funds obtained by issue of share capital. ITAT however observed that the interest free loan later compelled taxpayer to borrow interest bearing funds and thus resulted in erosion of tax base in India and held that TP adjustment by applying ALP interest rate should be

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made to the same. [*TVS Logistics* v. *DCIT*-*72 Taxmann.com 89 (Chennai)*]

Capacity utilisation adjustment-Adjustment to be made to data of the comparable

Taxpayer had demonstrated that there was an underutilisation of capacity in the relevant year however it had made adjustment in its own profitability as against adjustment in comparable data for the same. ITAT held that capacity adjustment cannot be denied however adjustment should be in the data of comparable companies. Further, as regards management fee the taxpayer had adopted TNMM while TPO held ALP for management fee to be NIL under CUP method. ITAT held that one can discard TNMM and adopt CUP only where a comparable service data is available and accordingly deleted the TP adjustment on this count. [*Frigoglass India Pvt. Ltd.* v. *ACIT ITA 784 / Del/2016,* Order dated 25-7-2016, ITAT, Delhi]

Dealings in shares 'allotted' is not a speculative dealing

Taxpayer in this case was engaged in business of dealing in chemicals and also shares. Some shares were allotted to it in Public Issues of different companies. It suffered loss on sale of these shares. AO treated the loss to be speculative in nature relying on explanation to Section 73 of IT Act. Said explanation provides that the part of business of a company consisting '*purchase*' and sale of shares shall be deemed to be speculative to that extent. Reliance was placed on the decision of *CIT* v. *TN Aravinda Reddy* for the proposition that word 'purchase' means buying for a price or equivalent of price. In that case release deeds by coparceners was held as resulting in purchase by taxpayer. The Gujarat High Court held that the decision of *TN Arvinda Reddy* is not applicable to the facts of the present case. It followed the decision of Supreme Court in the case of *Shri Gopal Jalan & Co* v. *Calcutta Stock Exchange* and *Khoday Distillaries* v. *CIT* and held that issue and allotment of shares result in creation of shares which is different from purchase. It accordingly held that sale of shares allotted in IPO does not tantamount to speculative transaction. *[AMP Spinning and Weaving Mills P. Ltd.* v. *ITO* ITA-957 of 2006 (Guj HC)]

Buy back of shares held by Mauritius Company is not a colourable device

Taxpayer was subsidiary of a Mauritian company and in the relevant year bought back its shares resulting in capital gains in the hands of parent. Relying on the Indo Mauritius treaty the gain was claimed as exempt from income tax in India. Revenue authorities alleged it to be a colourable device to avoid taxation of dividend. ITAT referred to the decision of *Capgemini* (Bombay High Court). The High Court in that case had held that if law (Companies Act, 1956) provides two modes for buying back shares namely, Section 391 read with Section 100 to 104 and Section 77A, the company cannot be compelled to choose the way that would result in higher tax outflow. Following this decision the ITAT accepted the contention of taxpayer that gain cannot be treated as dividend subjected to tax under

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Section 115 O. [*Korn Ferry International Pvt. Ltd. v. ACIT ITA-7367/Mum/2014,*]

Provision for IBNR and unidentified third party motor accident claims – Deductible in MAT

Taxpayer, an insurance company had created provisions for (a) Insurance incurred but not accounted (IBNR) and (b) Unidentified third party insurance claims. These provisions were claimed as deductible from book profits for the purpose of computing Minimum Alternate Tax (MAT). It was contended that IBNR is computed with the help of actuarial valuation methods and is in accordance with guidelines of IRDA and ICAI. Rejecting the arguments of revenue that it is an unascertained liability the ITAT held that the provision being based on scientific calculation with a proper rationale can be said to be an ascertained liability and therefore deductible from book profits. Third party insurance claims provision was made based on the summons received from court adjudicating motor accident claims and was in accordance with guidelines of General Insurance Corporation of India. Allowing the deduction the ITAT held that there is no uncertainty regarding liability though the quantum is uncertain. Based on this, ITAT concluded that uncertainty of quantum does not make the provision an unascertained liability. [*DCIT v. National Insurance Company ltd. 72 Taxmann.com 116 (Kol)*]

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