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MVDCO ADVISORY SERVICES

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INCOME TAX

Re: **Loreal India Pvt. Ltd.**

Sub: **Transfer Pricing of Advertisement, Marketing and Promotion (AMP) Expense.**

The Assessee Company spent huge amount on advertisement and marketing for their products. The TPO attributed such high AMP expenses on enhancing the brand value and therefore benefit to the brand owner which is the foreign AE.

The Tribunal made following observations:

- The cosmetic industry in India grew by 15-20% annually whereas the sales of the Company grew by 19 times in last 10 years. The Company made rapid progress in Indian market and AMP played an important role in it. The very nature of the business of the Company was such that it had to spend huge expenses to establish its products. It was also observed that there were huge expenses incurred for products launched specially for Indian market. These expenses cannot be considered to be aimed at benefiting the AE;

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- All the payments on account of AMP expenses were made to unrelated third parties. There was no evidence to prove that the Company had rendered any services to the AE under the head AMP expenditure.

- The fundamental question to be answered is whether in absence of any agreement for payment of AMP expenses by the AEs, can it be held that there was an international transaction only on the basis that AMP expenditure, incurred by the assessee, would have benefitted the AEs, who owned the brands used by the assessee. In our opinion, the arguments suffer from the very basic flaw that it presumes that the assessee would incur AMP not to promote its own business. In other words, the TPO has failed to prove that the real intention of the assessee in incurring advertisement and marketing expenses were to benefit the AEs and not to promote its own business.

It was accordingly held that the AMP expenditure was not an International transaction.

INCOME TAX

Amendment to India Mauritius Tax Treaty:

The Indian Government has issued a press release amending India Mauritius Double Tax Avoidance Agreement – the tax treaty. It is considered to be a historic step and will radically change manner of inflow of foreign investments in India.

Background:

Article 13(4) of The Tax Treaty provided that gains derived by a resident of Mauritius from sale of shares in an Indian Company shall be taxable only in Mauritius. India, therefore, do not have any right to tax such Capital Gain. Global investors looking to invest in Indian Companies were investing through Mauritius route taking benefit of this article and not paying any tax in India on sale of shares. Indian Tax authorities were always suspecting genuinity of these Mauritius entities and were alleging that these entities were shell Companies set up for treaty shopping/abuse thereby denying the benefits conferred under the treaty.

The amendment:

After long drawn deliberations, protocol has been signed between India and Mauritius that shifted the Capital Gain on sale of shares from resident base to source base taxation.

INCOME TAX *(cont.)*

The amendment will be applicable only in respect of the shares purchased on or after 1st April 2017. Therefore all the shares acquired prior to 1st April 2017 even if sold at a later date will be subject to erstwhile provisions of the treaty and will not be subject to tax in India.

A transition period is provided that for sale of shares between 1st April 2017 and 31st March 2019 the gain will be subject to tax in India at 50% of the applicable Indian Tax rate, subject to Limitation of Benefit (LOB) clause.

From 1st April 2019 and onwards, any capital gain on sale of shares will be taxed at full applicable Indian Tax rate.

According to newly inserted LOB clause, the benefit of 50% of the Indian tax rate will not be available to the Mauritius based Companies if its expenditure on operations in Mauritius is less than INR 2.70 million in the preceding 12 months.

INCOME TAX

Key Amendments to the Finance Bill 2016

The Lok Sabha passed the Finance Bill 2016 with the following key modifications:

- The period of holding of unlisted shares has been reduced from 36 months to 24 months to qualify as Long Term Capital Asset;

- Proposal to tax withdrawal from Provident Fund account has been done away with. Further, taxability of employers contribution over 12% of Salary was capped at under Rs. 150,000/- or 12% of salary. The ceiling of Rs. 150,000/- is removed;

- Tax incentives for startups have been extended to Limited Liability Partnerships (LLP) as well

- Exemption from Long Term Capital Gain on sale of shares on transfer of shares undertaken in foreign exchange on recognised stock exchange located in International Financial Service Center (IFSC) was proposed. It is now clarified that short term Capital Gains arising from transfer of shares undertaken on such stock exchange shall be taxed @ 15% even if no STT is paid.

INCOME TAX *(cont.)*

- It was proposed to levy tax at the rate of 10% on dividend income earned in excess of INR 1 million in case of individual, HUF or firm who is a resident in India. It was clarified that such tax shall be payable only on the amount of dividend exceeding INR 1 million. Further, it was also clarified that the limit of INR 1 million is for dividends received from all domestic companies taken together.

- According to the Patent Box tax regime, royalty earned in respect of patents developed and registered in India was proposed to be taxed at concessional rate of 10% on a gross basis, subject to the fulfilment of prescribed conditions. It is now further clarified that to avail the concessional tax regime, at least 75% of the expenditure for patent developments should be incurred in India.

- In cases of distribution to investors by Alternative Investment Funds (AIFs), it was proposed that where the unit holder is a non-resident, the withholding tax shall be lower of 10% or as per the rate provided under the relevant Double Taxation Avoidance Agreement (DTAA). It has now been further clarified that for non-residents, withholding tax would not be applied if the income is not chargeable to tax.

INCOME TAX

Equalisation levy of 6% on digital ad:

Considering the potential of new digital economy and the rapidly evolving nature of business operations it is found essential to address the challenges in terms of taxation of digital transactions as the typical direct tax issues relating to e-commerce are the difficulties of characterizing the nature of payment and establishing a nexus or link between a taxable transaction, activity and a taxing jurisdiction, the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes. In order to address these challenges, a new Chapter titled **"Equalisation Levy"** in the Finance Bill has been introduced, to provide for an Equalisation levy of **6%** of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment ('PE') in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

The government has found a way to indirectly tax companies such as Google and Facebook, a development which could set the stage for taxation of cross-border digital transactions and potentially drive up costs for advertisers.

Let us look into its intricacies as under:

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1. <u>Extent and Commencement:</u>

Provisions relating to equalization levy (i.e. Chapter VIII of Finance Bill, 2016) extend to the whole of India except the State of Jammu and Kashmir.

2. <u>Definitions:</u>

"Specified service" means **online advertisement**, **any provision for digital advertising space** or **any other facility or service for the purpose of online advertisement** and includes any other service as may be notified by the Central Government in this behalf.

3. <u>Charge of/exemption from Equalisation levy:</u>

   a) A person resident in India and carrying on business or profession; or

   b) A non-resident having a permanent establishment in India

Have to charge/deduct Equalisation levy at the rate of 6% of the amount of consideration for any specified service, paid or payable to a non-resident.

However, in following cases Equalisation levy **shall not be charged**:-

   a) The non-resident providing the specified service has a permanent establishment in India and the specified service is effectively connected with such permanent establishment;

   b) The aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from a person obliged does not exceed Rupees One lakh or

   c) Where the payment for the specified service is not for the purposes of carrying out business or profession.

4. <u>Payment of Equalisation levy and Interest/penalty:</u>

   a) **Payment of Equalisation levy deducted: -** by the 7th day of the month immediately following the said calendar month.

   b) **Interest on delayed payment:** Simple interest @ 1% of such levy for every month or part of a month

c) **Penalty for failure to deduct Equalisation levy:** Pay in addition to such levy and interest, a penalty equal to the amount of equalisation levy that he failed to deduct.

d) **Penalty for failure to pay Equalisation levy:** The levy which has been deducted but not paid, a penalty of **Rs. 1,000/- for every day** during which the failure continues. The penalty under this clause shall however not exceed the amounts of Equalisation levy that he failed to pay.

Note: - The penalty under this Chapter shall not be levied unless the assessee has been given a reasonable opportunity of being heard.

5. **Furnishing of statement:**

   Statement/return of Equalisation levy shall be filed annually i.e. after the end of each financial year.

6. **Punishment for false statement:**

   The assessee shall be punishable with imprisonment for a term which may extend to three years and with fine.

7. In order to avoid double taxation, **exemption under section 10 of the Act** for any income arising to a non resident from providing specified services on which equalisation levy is chargeable.

8. In order to ensure compliance with the provisions this Chapter**,** the expenses incurred by the assessee towards specified services chargeable under this Chapter shall not be allowed as deduction in case of failure of the assessee to deduct and deposit the equalisation levy to the credit of Central government.

INCOME TAX

No penalty on 'Aishwarya Rai' for TDS default if she relied on her CA's advice

FACTS

a) Assessee (Aishwarya Rai Bachchan) made payment of US $ 77,500 to a non-resident for development of website without deducting TDS under Section 195.

b) The Assessing Officer (AO) observed that payment made for development of website would fall within the meaning of 'fees for technical services' as per Explanation 2 to Section 9(1)(vii). Therefore, payment so made was taxable in India in hands of non-resident and, hence, assessee had made default for not deducting TDS while making such payment. Consequently, the AO imposed penalty under section 271C for not deducting the TDS.

c) Assessee submitted that she had not deducted TDS by relying upon advice of her CA. Therefore, penalty shouldn't be imposed as there was no mala fide intension on her part.

d) CIT(A) confirmed the order of AO. Aggrieved by the order of CIT(A), assessee filed the instant appeal before the tribunal.

The tribunal held in favour of assessee as under:

1) Section 273B provides that no penalty under section 271C should be imposed if assessee proves that there was a reasonable cause for failure to deduct TDS.

2) It is a well-accepted fact that every citizen of the country is neither fully aware of nor is expected to know the technicalities of the Income Tax Act. Therefore, for discharging their statutory duties and obligations, they take assistance and advice of professionals who are well acquainted with the statutory provisions.

3) In the instant case, assessee's CA had issued a certificate opining that tax was not required to be deducted at source on said remittance. Therefore, assessee under a bonafide belief didn't deduct TDS while making such remittance.

4) Therefore, failure on the part of the assessee to deduct tax at source was due to a reasonable cause. Hence, no penalty under Section 271C should be imposed- [2016] 68taxmann.com 324 (Mumbai - Trib.)