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RGNUL STUDENT RESEARCH REVIEW

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CHIEF PATRON'S MESSAGE

"In this world nothing can be said to be certain, except death and taxes."

- Benjamin Franklin

I am delighted to present the Second Issue of Volume Two of RGNUL Student Research Review (RSRR) in its second year.

The present edition of RSRR aims to provide a platform to students, academicians and legal practitioners to express their original thought on the contemporary legal issues. I sincerely believe that it would help in providing momentum to quality legal research.

This edition of the journal contains articles covering different aspects relating to "Taxation Laws". A successful economy is defined in terms of its robust tax policies and revenue collection regime. Extensive trans-boundary interaction among the sovereign nations requires a set of uniform principles, rules and regulations which are *sine qua non* to monitor and tax these transactions. In addition to this, various challenges such as "Double taxation","Base Erosion"& "Profit Shifting" etc. require initiatives by the world community as a whole to tactfully combat them. Therefore, the present issue of the journal aspires a detailed discussion on growth and implementation of Taxation Laws both at International and National levels.

I, on behalf of the students and faculty of RGNUL Punjab, express my deep gratitude to all the distinguished members of the Peer Review Board who have devoted their valuable time in reviewing the papers and providing their valuable insights. I would like to appreciate the efforts made by the Faculty Editor and the entire student-run Editorial Board. This issue of the RSRR, I hope, will be a trendsetter. I wish the journal all the best.

Professor (Dr.) Paramjit S. Jaswal
Chief Patron
RGNUL Student Research Review

PATRON'S MESSAGE

It is a matter of satisfaction that the present issue of RGNUL Student Research Review (RSRR) is continuing commendable success in the quest to promote legal education over a periodnow.The objective of RSRR is sharing of knowledge on current legal issues and to enhance the understanding of these issues through extensive research.

The current issue of the journal is on Taxation Law and it has received extensive participation and exchange of thought amongst the developing legal minds. In recent years taxation has come to be widely recognized as one of the most prominent and controversial topics in economic policy. Taxation plays a key role in business transactions and has the effect of making and breaking the business. The current era of globalisation calls for considerable research in Taxation Law which can play a facilitating role in our fast growing economy. Keeping in mind the significance of legal research in Taxation Law, RGNUL has always promoted the culture of academic deliberation and writing in its students.

RGNUL Student Research Review has achieved an unprecedented success by achieving new heights in quality of scrutiny involved in review and time bound delivery. Further, I would appreciate the hard work by students in making this journal internationally renowned,which has received contributions from across the India.

I would like to express my gratitude to all professionals and academicians who have joined to this initiative as a part of Peer Review Board and shared their enormous experience to the success of this journal. Further I would like to appreciate the efforts made by Dr. AnandPawar, the Faculty Editor for providing guidance to the Student Editors. I congratulate the Editorial Board of RSRR and all the young scholars who took out time from their academics for this outstanding initiative and wish them success in all their future endeavors. Finallly, I believe that the research papers will receive appreciation from the readersandexperts; and will be beneficial to all concerned.

Prof. (Dr.) G.I.S Sandhu
Patron
RGNUL Student Research Review

FOREWORD

It gives me immense pleasure to write the foreword for the third edition of the RGNUL Student Research Review (RSRR). I would like to take the opportunity to appreciate the efforts made by the students of RGNUL in the form of an Editorial Board for the successful completion of this edition. RSRR has inspired the young and innovative students to undertake legal research and articulate it in a comprehensible form. In the course of running the Review, the editors have not only learnt editing skills but also managerial skills.

I sincerely appreciate the effort of our student members of the Editorial board for their hard work and dedication because of which, it became possible to release this issue on time. They interacted with the leading academicians of this country, practicing advocates and other legal luminaries. Their support has been invaluable to us and I humbly thank them for the time they took out to review the articles that were submitted for consideration. I would like to take this opportunity to thank our contributors for their excellent work. This journal would not have been possible without the support that the student community all over the country has provided.

The Issue two of the third edition begins with the guest article from Dr. Vipan Kumar, Assistant Professor of Law, Rajiv Gandhi National University of Law, Punjab. He has very succinctly dealt with the concept of Place of Effective Management and the possible drawbacks associated therewith which require immediate attention.

Furthermore, the contributors have provided articles on a wide spectrum of topics, discussing on the interaction between international taxation and private international law, law on transfer pricing in India with reference to Double Irish Dutch Sandwich, and the issue relating to Value Added Tax (VAT) on building contracts whilst commenting on the case of *Larsen and Toubro Ltd.* v. *State of Karnataka*.

We would appreciate any further improvements in the journal as may be suggested by the contributors.

Dr. AnandPawar
Faculty Editor

TABLE OF CONTENTS

[GUEST ARTICLES]

PLACE OF EFFECTIVE MANAGEMENT

- **Dr. Vipan Kumar***

1. INTRODUCTION

The residential status of a person is an important issue under international taxation. Article 1 of the OECD and UN model conventions expressly make the double taxation avoidance agreements applicable on persons resident of either or both of the contracting states. Article 4 provides for the tie-breaker rule in case the person is resident of both the states. Article 1 read with article 4 acts as an anti-avoidance measure as they tend to confer treaty benefits only on residents. However, the rules regarding residential status of a person are not mentioned in model conventions. The rules are left to the individual states to be decided through their domestic statutes. The states are free to lay down any criterion, inter alia, domicile or nationality or period of stay or effective management.

The Income Tax Act, 1961 follows different criterion for different persons like individuals, Hindu Undivided Family (HUF), companies etc. The rules regarding residential status of an individual or HUF have not raised much controversy as compared to rules regarding residential status of a company. This article specifically deals with rules regarding residential status of a company in the changing scenario. The author has made a humble attempt to evaluate the present parameter, which has been recently introduced in Income Tax Act, 1961 for residential status of a company.

2. EVOLUTION OF CONCEPT REGARDING PLACE OF EFFECTIVE MANAGEMENT

* Assistant Professor of Law, Rajiv Gandhi National University of Law, Punjab.

Prior to the amendment of section 6(3) of *Income Tax Act*, 1961, a company was said to be resident in India if: (a) it was an Indian company, or (b) if during the relevant previous year, the control and management of its affairs was situated wholly in India. Thus, a company was non-resident company if: (a) it was not an Indian company, and (b) if the control and management of its affairs was situated wholly or partially outside India. The term '*control and management*' was interpreted as central controlling power and not day-to-day affairs of the company. As the central controlling power vests with the board of directors, the place where meetings of Board of Directors were held was a determining factor to decide '*control and management*' of the company. A foreign company could be termed as resident in India if its Board of Directors meetings took place in India. The situs of shareholders or their meetings was held to be insignificant for determining the '*control and management*' even if they are the ultimate owners, as in fact, the control and management vests with Board of Directors.[1]

The rules regarding residential status of a company was reconsidered by the Direct Tax Code.[2] Direct Tax Code proposed that a company should be resident in India if: (a) it was an Indian company, or (b) if its place of effective management, at any time in that year, was in India. Thus, the Direct Tax Code intended to shift the focus from 'control and management' of a foreign company to 'place of effective management'. This was the first time when concept of 'place of effective management' gained recognition in India.

The Parliamentary Standing Committee on Finance, in its forty-ninth report on Direct Tax Code bill observed that the definition of place of effective management was unclear and provided room for uncertainty. It recommended that residential status of a foreign company should be based on internationally accepted standards and judicially settled principles where there is a focus on place where key management and commercial decisions as a whole are made or where the 'head and brain' of the company is situated.[3]

Be it as it may, the Direct Tax Code has been shelved and the necessary amendments have been brought in the *Income Tax Act*, 1961 itself.[4] The

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1 Radha Rani Holdings Pvt. Ltd. v. ADIT, (2007) 16 SOT 495 (Del).

2 *Direct Tax Code*, clause 4.

3 Parliamentary Standing Committee on Finance, *Forty-Ninth Report on Direct Tax Code Bill*, 2011-12.

4 The *Income Tax Act*, 1961, section 6(3).

Finance Act, 2015 has amended section 6(3) of the *Income Tax Act*, 1961. The amended provision reads as follows:

> Section 6 (3): A company is said to be resident in India in any previous year, if –
>
> (i) it is an Indian company; or
>
> (ii) its place of effective management, in that year, is in India.

Thus, the concept of 'control and management' which decided residential status of foreign companies has been done away with. The statute now recognizes 'place of effective management' as the determining factor for residential status of foreign companies.

The explanation attached to the amended section 6(3) of the *Income Tax Act*, 1961 states that 'place of effective management' means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, are in substance made. However, this explanation does not clarify the meaning of 'place of effective management' with certainty.

The explanatory notes to the provisions of the *Finance Act*, 2015[5] state that the earlier concept of 'control and management' had become impractical as a company could easily avoid becoming a resident by simple holding a board meeting outside India. This could facilitate creation of shell companies, which are incorporated outside but controlled from India. The explanatory notes justify 'place of effective management' on the grounds that it is an internationally recognized concept. Further, it states that most of tax treaties entered into by India recognize the concept of 'place of effective management' for determination of residence of company as a tie breaker rule for avoidance of double taxation. However, it merely reiterates the wording of explanation attached to section 6(3) and does not explain the meaning of this term with certainty.

Realizing the need to explain the concept of 'place of effective management' and in compliance with the statement made in explanatory memorandum to the *Finance Bill*, 2015, the Central Board of Direct

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[5] Central Board of Direct Taxes, *Circular No. 19/2015*, dated 27 November 2015.

Taxes framed draft guiding principles for determination of place of effective management of a company. The document containing draft guiding principles was put in public domain for comments and suggestions.[6]

3. GUIDING PRINCIPLES ISSUED BY CBDT FOR DETERMINING PLACE OF EFFECTIVE MANAGEMENT

The Central Board of Direct Taxes has adopted a cautious approach while laying down the guiding principles for determination of place of effective management as if the assessing officer once decides that the foreign company has its place of effective management in India, then such company becomes a resident of India. The scope of its total income shall now include both Indian and global income. The guidelines provide two important checks on exercise of powers by the assessing officer. Firstly, the assessing officer shall seek the approval of Principal Commissioner or Commissioner, as the case may be, before giving finding which holds a foreign company as resident in India on the basis of place of effective management. The Principal Commissioner or the Commissioner shall provide an opportunity of being heard to the company before deciding the matter.[7] Secondly, the residential status of a company shall be determined on year-to-year basis and there shall be no blanket decision for a number of years.[8]

The Central Board of Direct Taxes categorically lays down that place of effective management depend upon the facts and circumstances of a given case. It should not be determined on isolated facts. A 'snapshot' approach should be avoided and activities performed over a period, during the previous year, need to be considered.[9]

The guiding principles lay down concept of 'active business' as a starting point of any probe to decide place of effective management of a company. The guidelines state that a company shall be engaged in active business outside India if: (a) the passive income is not more than 50% of its total income and (b) less than 50% of its total assets are situated in

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[6] Central Board of Direct Taxes, *Circular No. 142/11/2015-TPL*, dated 23 December 2015.

[7] *supra*6, at para 11.

[8] *id*., at para 6.

[9] *id*., at para 10.

India and (c) less than 50% of total number of employees are situated in India or are resident in India and (d) the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure. The foreign company having active business outside India shall be presumed to be non-resident if the majority of meetings of the board of directors are held outside India. However, if the board of directors have delegated their power to a person resident in India or holding company in India, then the place of effective management shall be considered to be in India and the foreign company shall become resident in India.[10]

For foreign companies other than those engaged in active business outside India, the guidelines lay down two-stage process to decide place of effective management. The first stage is identification or ascertaining the person or persons who actually make the key management and commercial decision for conduct of the company's business as a whole. The Second stage is determination of place where these decisions are in fact being made. The place where these management decisions are taken is more important than the place where such decisions are implemented.

The guidelines also lay down certain parameters, which should be taken into account for determining place of effective management in case active business is outside India. They are as follows:

(i) Location where a company's board regularly meet, if they retain the authority to make key management and commercial decisions. Otherwise, the place where other persons on whom this power has been delegated meet;

(ii) Location of company's head office, if the company has a centralized management system. Otherwise, the place where senior managers along with their supporting staff are located;

(iii) Place where main and substantial activity of the company is carried out; and

(iv) Place where accounting records of the company are kept.

The guidelines prescribe that in case meetings are held through use of modern technologies like video conferencing, the place of effective

[10] *id.*, at para 7.

management should be the place where senior managers or persons taking key management and commercial decisions actually located.

Thus, the guidelines tend to make a comprehensive structure for deciding place of effective management, which is *sine qua non* for judging the residential status of a foreign company.

4. Issues for Consideration while Determining Place of Effective Management

Merwe, in his article, lays down five important issues for consideration while determining place of effective management in South Africa's context.[11] These five issues are equally important in Indian context. They are discussed as follows:

4.1. Who Manages A Company?

There is difference between shareholders' control and management of a company. The shareholders may be the owner of a company, however, the ultimate management vests with the board. The board may exercise this control on their own by making key management and commercial decisions themselves or they may delegate it to some organ / board committee / senior managers / shareholders etc. Thus, the situs of board's meeting or location of the person / organ on whom the authority has been delegated becomes important. CBDT guidelines also lay stress on the location of board's meeting or in case powers are delegated, to the location of persons / managers / organs on whom these powers have been delegated.

4.2. Level of Management:

The level of management which is important for determination of place of effective management is the superior management instead of daily hands on management. Thus, it is the situs of organ / location of persons taking superior management decisions important. The location of managers exercising daily hands on control is not important. The CBDT guidelines also lay stress on the superior level of management. It categorically lays down that day to day routine operational decisions

[11] BA Van Der Merwe, *Residence Of A Company – The Meaning of Effective Management*, 14 South African Mercantile Law Journal 79, 92 (2002).

undertaken by junior and middle management shall not be relevant for the purpose of determination of place of effective management.

4.3 Nature of Effective Management:

The term 'effective management' is ambiguous. This test is difficult to apply. It depends on the facts and circumstances of each case. However, effective management is a rule of substance over form. It is better than rule of incorporation as incorporation is open to manipulation. The CBDT also admits this fact. The guidelines expressly mention that the test relating to place of effective management is a rule of substance over form.

4.4 Guidance from Meaning of Management and Control:

The term 'management and control' as used in the *Income Tax Act*, 1961 may be comparable to 'place of effective management' but not identical. They are comparable as both refer to superior level of management and not the day to day control. However, the difference between these two concepts lie in the fact that 'management and control' may invariably yield multiple residences whereas 'place of effective management' can yield only one residence.[12]

4.5 Situations Where Company has More Than One Place of Effective Management:

The CBDT clearly states that there can be more one place of management but there can be only one place of effective management. Thus, in cases where there are more than one place of management, the dominant place shall be the place of effective management.

5. CONCLUDING REMARKS

The introduction of concept regarding 'place of effective management' is definitely an important milestone under *Income Tax Act*, 1961 as it is a rule of substance over form. However, it raises many issues, which shall remain unsettled until a clear verdict comes from the constitutional courts or CBDT clarifies its stand. Firstly, the sanctity of tax residency certificate issued by the foreign jurisdiction to the foreign company shall be doubted unilaterally by the income tax department of India. The

[12] *supra*11, at p. 92.

foreign company may end up being a resident in both the states. Secondly, the tie breaker rule for resolving dual residency position of the foreign company shall become ineffective as place of effective management itself is a tie breaker rule under tax treaties. Thirdly, the applicability of tax treaties shall become an issue in triangular cases where the company is incorporated in a third state. Further, the issues relating to applicability of lower rate of withholding tax and applicability of minimum alternative tax shall arise. It is desired that these issues are taken up by the CBDT at the earliest possible opportunity and resolved to the best interest of all stakeholders. It shall provide clarity to the foreign companies and promote foreign direct investment in India.

[ARTICLES]

DOUBLE IRISH DUTCH SANDWICH AND THE INDIAN TRANSFER PRICING LAW

- **Prakhar Gupta***

ABSTRACT

Tax avoidance is something that has existed since the very concept of a paternalistic state and the need for levying taxes was introduced in the fabric of modern day societies. A slight reduction in the percentage of tax payable can cause a remarkable increase in the profits of a business enterprise and thus, taxpayers always find some way or the other to reduce their tax liability. In recent years, some of the biggest multi-national corporate giants including Apple and Facebook have been able to drastically reduce their tax liability by shifting their incomes from high tax jurisdictions to countries where the rate of taxation is minimal. One of the novel ways used by these giants to hoodwink national governments and avoid tax is what is now popularly called as the Double-Irish-Dutch Sandwich.Since, a lot of academic ink has not been spilled on the subject; this paper tries to contribute to the existing Transfer Pricing Jurisprudence in two ways. First, it tries to explain the background for a better understanding of the issue. Second, it will elaborate and analyse the various arguments that can be adduced from the assessee and the revenue and argue for reforms. The paper is divided in five parts. The first part delineates the Double-Irish Dutch structure briefly. The second part explains the various methods for calculating the arm's length price under Section 92C of the Indian Income Tax Act, 1961. The third and the fourth parts expound the various arguments that can be put forward by the revenue and the assesse respectively, and the final part concludes the paper by arguing for some reforms in the existing legal framework related to Transfer Pricing in India.

1. INTRODUCTION

Tax avoidance is something that has existed since the very concept of a paternalistic state and the need for levying taxes was introduced in the

* Student, National Law School of India University, Bangalore.

fabric of modern day societies. A slight reduction in the percentage of tax payable can cause a remarkable increase in the profits of a business enterprise and thus, taxpayers always find some way or the other to reduce their tax liability. In recent years, some of the biggest multi-national corporate giants including Apple and Facebook have been able to drastically reduce their tax liability by shifting their incomes from high tax jurisdictions to countries where the rate of taxation is minimal. As news and reports of various tax avoidance strategies adopted by these multi-national giants became public, an intense public debate to curb the same was triggered, which has brought the issue to the zenith of the international tax policy agenda.[1]One of the novel ways used by these giants to hoodwink national governments and avoid taxes is now popularly called as the *Double Irish Dutch Sandwich*. The author, with the help of this paper, has tried to explain the problems created by this arrangement and analyse whether or not the Indian Transfer Pricing Law is equipped to adequately deal with the same. Since, not a lot of academic ink has been spilled on the subject, this paper contributes to Transfer Pricing jurisprudence in two ways. First, it will try to provide a background for a better understanding of the issue. Second, it will elaborate and analyse the various arguments that can be adduced from the assessee and the revenue and argue for reforms.

The article is divided into five parts. The first part briefly delineates the *Double Irish Dutch Sandwich* as used by multi-nationals to shift their incomes from high tax jurisdictions to low tax havens. The second part deals with explaining the various methods of calculating the arm's length price in international transactions between related entities under the Indian Transfer Pricing Law. Various arguments that can be adduced by both taxing authorities and the assessee are explained in the third and fourth parts and the author's conclusions and suggestions are given in the last part of the paper.

2. DOUBLE-IRISH DUTCH SANDWICH: THE STRUCTURE

[1] Clemens Fuest et al., *Profit Shifting and 'Aggressive' Tax Planning by Multinational Firms: Issues and Options for Reform*, Discussion Paper No. 13-044, available at http://ftp.zew.de/pub/zew-docs/dp/dp13044.pdf(last accessed on 26 August 2015).

The tax planning strategy that Google, Apple and many other multinationals use to reduce their tax liability has become famous as '*Double Irish Dutch Sandwich'*. As the name suggests, the structure involves two companies incorporated in Ireland, one company holding Intellectual Property Rights and one Operating Company, and one Conduit Company established in the Netherlands. For a better understanding of how the entire structure works, let's assume that Elixir India is a major pharmaceutical company which manufactures drugs based on the traditional Ayurvedic knowledge in India. A newly formulated drug which was developed by the company in India after incurring heavy expenses in its research and development can help it make a windfall. The company however, creates a wholly owned subsidiary in Ireland (Elixir Ireland 1) and licenses the Intellectual Property Rights (hereinafter referred to as **'IPRs')** to this company at a Cost-Plus Mark-up price, since Ireland is a very suitable destination for holding intellectual property assets due to Ireland's favourable tax regime for IP holding companies. Though this company is incorporated in Ireland, it is controlled from Malta and thus, for Irish tax purposes it is a Maltese company. Now, Elixir Ireland 1 creates another subsidiary (Elixir Netherland) and licensed the IPRs on the new drug to this new formulated company. Elixir Netherland in turn creates another subsidiary namely Elixir Ireland 2. It is Elixir Ireland 2 which exploits the IPRs, manufactures and sells the new drug, thereby making huge profit. However, since it was wholly owned by Elixir Netherlands, the company transfers 99% of its profits to the latter as royalty which in turn transfers them to Elixir Ireland 1. This whole arrangement leads to huge tax savings for the company for a number of reasons. First, since Malta does not impose any tax on its corporations on royalties received from patents, copyrights and trademarks,[2] Elixir Ireland 1 does not have to pay any tax. Second, Elixir Netherland helps the company to avoid the withholding tax that Ireland imposes on foreign companies. Since, there is a tax treaty between Ireland and Netherlands, the company does not have to pay any withholding tax. Finally, since there are no withholding taxes under the Dutch law, Elixir Netherlands can transfer all its profits to Elixir Ireland 1 (which is a Maltese company) without

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[2] Jeffrey Rubinger and Summer Ayers Lepree, *Death of the "Double Irish Dutch Sandwich"? Not so Fast*, available at http://www.taxeswithoutbordersblog.com/2014/10/death-of-the-double-irish-dutch-sandwich-not-so-fast/ (last accessed26 August 2015)though the Irish Finance Minister recently proposed reforms that would cause corporation incorporated in non-resident corporations to be taxed as resident firms, the reform proposal is not enough to end the Double-Irish Dutch Sandwich because of the various treaty obligations that Ireland has with several low tax jurisdictions.

paying any tax. The matters can get worse if an Advanced Pricing Agreement was signed by the assessee and the revenue.[3]

While the structure appears legitimate at first and the transfer of IPRs by the Indian company to its Irish subsidiary seems at arm's length price since it is done at a Cost-Plus mark-up which is higher than the mark-ups in similar transactions, a deeper analysis shows otherwise. It is in this background that the Transfer Pricing laws and Section 92 of the Income Tax Act become important.

3. METHODS TO CALCULATE THE ARM'S LENGTH PRICE: SECTION 92C

Before the author can move on to explain and analyse the possible arguments that can be put forward by the respective parties, it is essential to briefly explain the various methods for calculating the arm's length price in an international transaction.[4]The various methods for computing the arm's length price are mentioned in Section 92C of the Income Tax Act, 1961. As per the Section, the five methods[5] are:

(1) Comparable Uncontrolled Price Method
(2) Resale Price Method
(3) Cost-Plus Method
(4) Profit Split Method
(5) Transactional Net MarginMethod

Further, there is no hierarchy among these methods. The Most Appropriate Method for any transaction has to be determined keeping

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3 As per Section 92CC of the Income Tax Act, 1961, an Advanced Pricing Agreement is an agreement signed between the assessee and the revenue for determining the arm's length price or specifying the manner in which it is to be determined. Further, once the agreement has been entered into, it alone governs the calculation of the arm's length price notwithstanding anything contained in Section 92C. The agreement is binding on both the assessee and the revenue and it has all the requisites of a legally binding contract.

4 The term 'International Transaction' is defined by Section 92 of the Income Tax Act. As per the section, 'international transaction' means any transaction which happens between two or more associated enterprises, one of whom should be a non-resident. This transaction can range from the purchase, sale or lease of both intangibles and intangibles to the provision of services, lending of money or any other transaction having any kind of bearing on the profits of the enterprise.

5 The *Income Tax Act*,1961, section 92C; the Central Board of Direct Taxes may also specify any other method if it so deems fit.

in mind the various factors enumerated in Rule 10C of the Income Tax Rules.[6]

3.1. Comparable Uncontrolled Price Method

This method is the most direct method for computing the arm's length price. Under this method, the price at which a transaction between associated enterprises is purported to be carried out is compared to the price obtained in a similar/comparable uncontrolled transaction. Comparable Uncontrolled transaction means any transaction which is in all material aspects similar to the international transaction in question. This method is the easiest and is the most appropriate method when details regarding similar transaction, whether internal or external, are available.[7]

3.2. Resale Price Method

Resale Price Method is the most appropriate method when the seller, who is an associated enterprise, adds little value to the goods and does not alter the goods physically before selling it again to a third party. In other words, this method is the best method in case of distribution activities and services. The first step under this method is to identify the price at which the goods or services were sold to the unrelated party. The second step involves deducting the gross profit from the resale of such property and any expenses incurred by the firm while reselling. The adjusted price arrived at will be the arm's length price.[8]

3.3. Cost-Plus Method

Comparable Uncontrolled Price Method and Resale Price Method can be difficult to apply in cases where no comparable transactions are available. This problem is, to some extent, solved by the other three methods mentioned in Section 92C including the Cost-Plus Method. The Cost-Plus Method begins by taking into account the costs incurred by the supplier of goods or services in a controlled (related party

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[6] As per Rule 10C, the Most Appropriate Method (MAM) has to be determined keeping in mind the nature and class of international transaction, assets employed and risks assumed by each associated enterprise, availability of comparable uncontrolled transactions and the nature and reliability of assumptions required for the application of the method.

[7] Deloitte, *Transfer Pricing Law and Practice in India*, 181 (2nd ed., 2009).

[8] *Income Tax Rules,* 1962, rule 10B.

transaction), to which an appropriate mark-up is added, to account for an appropriate profit considering a number of factors including the risks assumed, functions performed and assets employed.[9] The price thus reached is the arm's length price for the transaction in question. In cases where comparable transactions of the tested party with an independent party are not available, resort can be made to comparable dealings of independent parties in uncontrolled parties. This method is the most appropriate method when the transaction in question involves provision of services, a long-term buy and supply agreement, sale of semi-furnished goods or specialised goods like military equipment.[10]

3.4. Profit-Split Method

Under the Profit-Split Method, the arm's length price for an international transaction between associated enterprises is determined by taking into account the consolidated netprofits of the company as a whole and dividing the same on an economically valid basis. The profits have to be divided keeping into account a host of factors such as contributions made by each firm, risks assumed, assets employed etc.[11] Profit-Split Method can be used even when no comparable transaction is available. However, since an important step while applying this method is analysing the contributions made by each associated enterprise, it might pose difficulties for tax authorities to process information from foreign affiliates.[12]

3.5. Transactional Net Margin Method

Under the Transactional Net Margin Method, the net profit of the firm from an international transaction is determined and compared with the net profit margins of comparable firms in uncontrolled transactions after adjusting and accounting for differences which may materially affect the net profit margins in open market. The net profit margin realised after comparing with uncontrolled transactions after taking into account and adjusting for all the difference is then used to arrive at the arm's length price.[13]

[9] *supra* 7, at p. 199.
[10] V.S Vahi, *Transfer Pricing: Law, Procedure and Documentation,* 102 (2004).
[11] *Income Tax Rules*, 1962, Rule 10B (d).
[12] *supra*10, atp.116.
[13] *supra*10, atp.122.

4. ARGUMENTS THAT CAN BE ADDUCED ON BEHALF OF REVENUE

In such cases, the revenue is most likely to agree with the assessee on the applicability of the Cost-Plus Method since the mark-up on cost selected by the assessee for the computation of arm's length price is higher than it is in similar transactions. However, once the revenue gets wind of the further transactions that happen between the various subsidiaries, it would try to re-assess the income of the assessee. Some of the arguments that can be put forward by the revenue are as follows:

4.1. Profit- Split Method was the Most Appropriate Method

The first argument that the Revenue could take to protect the company from shifting its income to low tax jurisdictions is the applicability of the Profit-Split Method. The Revenue can contend that the Profit-Split Method is the most appropriate method for a number of reasons as follows:

4.1.1. Comparables are not available

As mentioned above, under the Cost-Plus Method, arm's length price for an international transaction is determined by adding a normal gross profit mark-up to the sum of both direct and in-direct costs incurred by the enterprise to develop the property or for the provision of services. After the mark-up is determined, it is adjusted to take into account functional, risk and other differences between the international transaction and uncontrolled transaction which are comparable to the transaction in question. The costs are then increased by such mark-up and the sum arrived is the arm's length price.[14]The OECD guidelines on Transfer Pricing also lay down the same rules for the application of CPM.[15]Thus, one essential condition for the application of CPM is finding uncontrolled transactions, which are comparable to theinternational transaction in question.Thus, it was observed in *Assistant Commissioner of Income Tax, Circle 2, Nashik* v. *MSS India (P) Ltd.*[16], that:

[14]*Income Tax Rules*, 1961, Rule 10B(c).

[15] OECD (2010), *OECD Transfer pricing guidelines for Multinational Enterprises and Tax Administrations*, ¶2.39, (22/07/2010), available at http://www.oecd.org/ctp/transfer-pricing/45765701.pdf (last accessed on 28 August 2015).

[16]Assistant Commissioner of Income Tax, Circle 2,Nashik v. MSS India (P) Ltd, [2009] 32 SOT 132 (Pune); See also, Assistant Commissioner of Income Tax, Mumbai v.

> When we are applying a traditional or standard method of ALP determination, all that is to be seen is whether or not the mark up over costs relating to such sales to Associated Enterprises (AE) or the prices of such sales to AEs are comparable with mark up over costs relating to such sales to non AEs or prices at which same product is sold to non AEs…

Since, the transaction involved the licensing of unique intangibles, no comparable was available and hence, Cost-Plus Method cannot be applied. On the other hand, finding comparables is not *the sine qua non* for applying the Profit-Split Method.In the absence of external data as to how independent, enterprises would have split the profits in an uncontrolled transaction; the best judgement analysis taking into consideration the functions performed, risks assumed etc. can be used to split the profit.[17]The Income Tax Rules stipulate the same.[18]Thus, in *Altman Delta Corporation* v. *Commissioner of Internal Revenue*[19]*,* Profit-Split Method was chosen over the Cost-Plus Method since the comparability analysis done by the revenue was flawed and no other comparables were available.Similarly, in *Eli Lilly v. Commissioner*[20], the profit was split between an American company and its subsidiary in Puerto Rico using the best judgment method in a ratio of 45:55. Thus, Profit-Split Method and not Cost-Plus Method should have been applied.

4.1.2. The transaction involved the transfer of intangibles

Profit-Split Method is usually the most appropriate method in transactions, which involve the transfer of unique intangibles.[21] The OECD guidelines on transfer pricing also regard Profit-Split Method as the most appropriate method to determine the arm's length price for the sale or licensing of unique intangibles.[22] Since, the transaction in question involved transfer and licensing of unique intangibles, Profit Split Method was the most appropriate method.

Tara Ultimo Pvt.. Ltd. ; Income Tax Officer, Baroda v. Kawin Interactive (P.) Ltd., IT Appeal Nos. 4474, 4475 (Ahd.) (2007).

[17]*supra* 15, at2.111.

[18]*Income Tax Rules*, 1962, Rule 10B(d)(ii).

[19] Altman Delta Corporation v. Commissioner of Internal Revenue, 246 F.3d 49, 70 (2d Cir.,2001).

[20] Eli Lilly v. Commissioner, 84 T.C. 996 (1985).

[21]Income Tax Rules,1962, Rule 10B.

[22]*supra* 15, at 2.109.

4.1.3. The Company (Elixir India in this case) was an entrepreneurial research and development centre

Circular number 6/2013, which was issued by the CBDT on June 29th, 2013, classified development centres into three categories: Entrepreneurial research and development centres, Centres which are based on cost sharing arrangements, and Contract research and development centres.[23] As per the guidelines given in the Circular, a centre will be called a contract and development centre with insignificant risks only when the parent company performs all the economically significant functions, the parent company provides the intangibles funds and assets for the development of the product including intangibles or the Indian company works under the supervision of the foreign company.[24] Further, the Circular also makes it explicitly clear that an Indian company will be assumed to bear all the risks if the parent company or foreign affiliate is located in a low tax jurisdiction. In the instant case, all the economically significant functions were performed by the Indian Company (Elixir India) and it did not work under the supervision or control of any of the foreign companies (Elixir Ireland or Elixir Netherland). Furthermore, Elixir Ireland 1 was controlled and managed from Malta, which is a low tax jurisdiction since it does not impose any tax on royalties received from the licensing of intangibles. Thus, the Indian company was an entrepreneurial research and development centre and not merely a contract research and development centre. It is a settled business-principle that the profits in business depend on risks i.e. higher the risks, higher will be the rate of profit. In the instant case, since the Indian company bore all significant risk, remunerating it only for the transfer of intangibles at a mark-up above the costs was not justified.Central Board of Direct Taxes, *Circular No. 19/2015*, dated 27 November 2015

4.1.4. The Revenue does not need to furnish any material

The assessee can contend that the revenue cannot re-assess its income that too without providing any information or material about the inadequacy of the method already employed. In response to such an argument, the revenue may argue that it does not need to furnish any

[23] Central board of Direct Taxes,*Circular 6/2013*, dated 29 June 2013, available at http://law.incometaxindia.gov.in/DIT/File_opener.aspx?page=CIR&schT=&csId=0fb5c6c3-a839-4fb5-ab5e-9f46f89c97c0&crn=&yr=ALL&sch=&title=Taxmann%20-%20Direct%20Tax%20Laws (last accessed on 28 August 2015).

[24] *ibid.*

material in order to impugn the method already employed for the computation of the arm's length price. For doing the same, the revue may rely on several rulings.In *Serdia Pharmaceuticals* v. *Assistant Commissioner of Income Tax, Mumbai*[25], it was observed that if the assessing officer is of the opinion that the method adopted by the appellant is not the most appropriate method in light of the facts and circumstances of a case, he has powers and a corresponding duty to reject the method adopted and he need not show that the arm's length was not calculated according to the provisions of section 92 of the Income Tax Act, 1961.[26]

4.2. The Revenue has the jurisdiction to tax the offshore transactions of the company

One of the main contentions from the assessee can be the want of jurisdiction of the Revenue to tax the offshore transactions of the company i.e. transactions which, in this case, happened between Elixir Ireland 1 and its subsidiaries. The revenue can in turn take two counter-arguments in response to this as follows:

4.2.1. Offshore transactions can be taxed by using the Profit-Split Method

Since, the revenue has already argued for the applicability of the Profit-Split Method, it can take into account the net profits of the company as a whole, including the profits made by its subsidiaries and split them after analysing the functions performed and risks assumed by each entity.The company can contend that since the Indian Company was just a Permanent Establishment of the Irish Holding Company, therefore the Income Tax Department (hereinafter referred to as **'ITD'**) has no jurisdiction to tax the income that is not reasonably attributable to the operations carried out in India. To rebut the same, the revenue can rely on a number of cases including Morgan Stanley,[27] which was pronounced by the honourable Supreme Court in 2007. In this case, it was observed by the apex court if the Indian Company bears substantial risks, the ITD can tax the income of the company for the risks that it is bearing. Since, the Indian company (Elixir India) bore risks for the

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[25]Serdia Pharmaceuticals v. Assistant Commissioner of Income Tax, Mumbai, ITA Nos: 2469/Mum/06, 3032/Mum/07 and 2531/Mum/08, Assessment year: 2002-03, 2003-04 and 2004-05.

[26]*ibid.* See Also, Assistant Commissioner Income Tax, Mumbai v. Sonata Software Ltd, ¶16, [2013] 29 taxmann.com 144 (Mumbai - Trib.).

[27] Director of Income Tax (International Taxation) v. Morgan Stanley and Co., [2007] 162 TAXMAN 165 (SC).

development of the intangibles which was very crucial for any further offshore transactions; the ITD has the jurisdiction to tax the income accruing from the same by applying Section 9(1) of the Income Tax Act, 1961, which empowers the ITD to tax a non-resident for the profits that can be reasonably said to have accrued due to operations carried out in India.[28]

4.2.2. The 'Look at Principle'

Associated enterprises very often structure their transactions in a way which minimises their tax liability.[29] To prevent the same, the revenue can resort to 'Look at Principle'. The principle was explained by the Supreme Court in *Vodafone International Holdings Ltd.* v. *Union of India*[30]. The court held that the tax authorities must ascertain the legal nature of certain transactions by following the 'look at principle' where the transaction must be looked at as a whole without dissecting it to see if the transaction is meant for tax avoidance or not. The Transfer Pricing Officer's task is therefore to often look behind the facts as they seem and arrive at the substance of the transaction to compute the value of the transaction. Thu, the revenue has jurisdiction to tax the income of the company as a whole by invoking the 'look at principle'.

5. ARGUMENTS FROM THE COMPANY

To rebut the arguments adduced by the revenue, the company can also take a number of arguments. Some of the major arguments that can be put forward by the company are as follows:

5.1. The Cost-Plus Method is the most appropriate method

Contrary to the stance taken by the revenue, the company would argue for the applicability of the Cost-Plus Method on the following basis:

5.1.1. The transactional profit methods are methods of last resort

According to the OECD guidelines on Transfer Pricing, even though the application of the MAM depends on the facts and circumstances of

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[28]The *Income Tax Act*, 1962, Section 9(1), Explanation 'a'.

[29]*supra* 18. See also, Li and Fung India (P) Ltd. v. Commissioner of Income Tax, [2013] 40 taxmann.com 300 (Delhi).

[30]Vodafone International Holdings Ltd. v. Union of India, Civil Appeal No.733 of 2012, (arising out of S.L.P. (C) No. 26529 of 2010).

each case, the traditional methods including the CPM is preferable over transactional net profit methods including the Profit-Split Method.[31] Though Section 92C (1) of the Income Tax Act, 1961 does not give preference to any method over others, judgements given by various tribunals up-held that the Transactional Profit Methods are methods of last resort. Thus, in *Assistant Commissioner Income Tax, Mumbai* v. *Sonata Software Ltd.*[32]*,* it was observed that the transactional profit methods are to be considered methods of last resort and ordinarily only traditional methods should be applied. Similar observations were made in *Philips Software Centre Pvt Ltd* v. *Assistant Commissioner of Income Tax*[33].

5.1.2. There is an agreement for the provision of services

According to the OECD guidelines on Transfer Pricing, Cost-Plus Method is the most appropriate method in cases where there is an agreement for the provisions of services. The guidelines define intra-group services as any activity that provides any group member or the whole group with economic or commercial value to enhance its commercial position.[34]Thus, in *Li and Fung India (P) Ltd.* v. *Commissioner of Income Tax*[35], Cost-Plus Method was considered as the most appropriate method since there was a provision of services by LFIT (subsidiary) to its parent company. Similarly, it was observed in *Aztec Software and Technology Services Ltd.* v. *Assistant Commissioner of Income Tax*[36]*,* that the Cost-Plus Methodis usually used in cases which involve the provision of services. Since, the Indian Company was providing research and development services to the Irish company, Cost-Plus Method would be most appropriate.

5.1.3. The Indian Company (Elixir India) was a mere contract research and development centre

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[31] OECD (2010), *OECD Transfer Pricing Guidelines for Multi-National Enterprises and Tax Administrations*, ¶2.3, 60 (22/07/2010).

[32] Assistant Commissioner Income Tax, Mumbai v. Sonata Software Ltd, ¶16, [2013] 29 taxmann.com 144 (Mumbai - Trib.).

[33] Philips Software Centre Pvt Ltd v. Assistant Commissioner of Income Tax, [2008] 26 SOT 226 (Bang.). See also, Assistant Commissioner of Income Tax, Circle 2, Nashik v. MSS India (P) Ltd, [2009] 32 SOT 132 (Pune).

[34] OECD(2010), *OECD Transfer Pricing Guidelines for Multi-National Enterprises and Tax Administrations*, ¶7.6, (22/07/2010).

[35] Li and Fung India (P) Ltd. v. Commissioner of Income Tax, [2013] 40 taxmann.com 300 (Delhi).

[36] Aztec Software and Technology Services Ltd. v. Assistant Commissioner of Income Tax, 2007 107 ITD 141.

The risk borne by a contract R&D centre is lower compared to fully entrepreneurial enterprises. Where a company provides captive contract software development service, it is immune from all risks that arise from market fluctuations, on account of it being assured of appropriate mark-up on costs.[37] Similarly, in *Li Fung*[38] where the subsidiary assumed risks and put in its resources for the development of tangibles as well as unique intangibles for its parent company, it was still observed that the company was just a service provider and not an entrepreneurial entity since it was immune from all kinds of risks that arise from market fluctuations. In the instant case, since the Elixir India was immune from all kind of risks including, market, credit and product development risks, it was a mere Contract research and development centre and hence, a mark-up on costs was justified.

5.1.4. Applicability of safe-harbour rules

The government vide its press release issued on 14/8/2013 notified the safe harbour rules.[39] According to Rule 10TD of the said rules, a company providing development services wholly or partly relating to generic pharmaceutical drugs will be protected if the operating profit margin of the assessee for the international transaction in relation to its expenses is more than 29 per cent.[40] The company can contend that since the operating profit for the transaction in question was more than 29 per cent, the safe harbour rules will be applicable and no adjustments are required.

5.2. Revenue does not have jurisdiction to tax the offshore transactions of the company

Another important argument that can be put forward by the company is the want of jurisdiction of the Indian Income Tax Department to tax the offshore transactions of the company. The major arguments can be:

5.2.1. Tax can be imposed only on the income received by the Indian company for the R&D work

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[37]Philips Software Centre Pvt Ltd v. Assistant Commissioner of Income Tax, [2008] 26 SOT 226 (Bang.).

[38]*supra* 35.

[39]Central Board of Direct Taxes,*Press Release*, Transfer Pricing Safe harbour Rules, available at, http://www.itatonline.org/info/index.php/transfer-pricing-final-safe-harbour-rules-available-for-download/ (last accessed on 28 August 2015).

[40]*ibid*; For the applicability of these rules to other industries, see Rule 10TD(2).

The Irish company is earning profits from the sale of the drug by its subsidiary. The subsidiary company is responsible for the exploitation of the IPRs, the formulation of the drug and its sale subsequently. None of these operations are carried out in India. Hence, the profits accruing out of the sale of the drug cannot be reasonably attributable to the Indian company's operations carried out in India. Since both the Irish company and its subsidiary are non-residents of India as per Section 6 of the Income Tax Act, 1961,[41] the income accrued in India by these companies would be governed under Section 9 of the Act. Section 9(1)(i), Explanation 1 states that when all the operations of a business are not carried out in India, only that part of the income which is reasonably attributable to the operations carried out in India would be deemed to have accrued in India.[42] In *Li Fung*,[43]it was held that even if the Indian Company provided assets and assumed risks for the development of unique intangibles, the tax authorities were misdirected in deciding that LFIL assumed substantial risks. Since, LFIL did not have any expertise in the manufacture of garment nor did it bear any risks for the manufacture and export of garments, it cannot be held to be a part of transaction with the third party vendors. Applying the ration to the instance case, the revenue does not have jurisdiction to tax the offshore transactions of the company.

5.2.2. The Indian company was a mere Permanent Establishment of the Irish Company for tax purposes

Section 92F of the Income Tax Act, 1961 defines a permanent establishment (hereinafter referred to as **'PE'**) as *a* permanent place from where the business of an MNE is wholly or partially carried out.[44] The definition given under Section 92F is an inclusive definition and includes service PE, agency PE etc.[45] Since, employees and technical experts from the Irish subsidiary frequented the office of the Indian company, the Indian company (Elixir India) was a mere PE of the Irish

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[41]The *Income Tax Act*, 1961, section 6.

[42]The *Income Tax Act*, 1961, section 9(1)(i). See also, Dy. CIT v. Roxon Oy., [2007] 291 ITR 275 (AT).

[43]*supra* 35; the Court clearly ruled that to attribute the profits of manufacture and export to LFIL would lead to a "completely unwarranted inference" that LFIL was a partner of the manufacturer vendor even when all the costs and substantial risks involved for the manufacturing and export were borne by third parties and not LFIL.

[44]The *Income Tax Act*, 1961, section 92F(iii).

[45]Director of Income Tax (International Taxation) v. Morgan Stanley and Co., [2007] 162 TAXMAN 165 (SC).

company so far as the transaction in question is concerned.[46] Since, a foreign enterprise is only liable to be taxed in India on so much of its business profits as is attributable to the PE,[47] and the Indian company is a PE of the Irish Company, the ITD has no jurisdiction to tax anything except that part of the business profits earned by Irish Company which can be attributed to operations carried out by the Indian company in India.

6. CONCLUSIONS AND SUGGESTIONS

Associated enterprises very often structure their transactions in a manner most conducive to helping them avoid taxes.It is for this very reason that Transfer Pricing has become one of the most important subjects in International Taxation. In recent years, multi-national giants like Google and Facebook has resorted to a new arrangement for shifting their incomes to low tax havens like Bermuda and Malta. This arrangement popularly called as *the Double Irish Dutch Sandwich* can help such multi-nationals to drastically reduce their tax liability and save hefty amounts of their operating profits. With the help of this paper, the author explained the structure of the Double Irish Dutch Sandwich by using a hypothetical and the arguments that can be adduced by the revenue as well as the assessee. From the arguments explained in detail above, it is evident how the structure can tangle up the Indian Income Tax Department in unending litigation and transfer pricing adjustments, thereby causing huge loss to it. Even though the law related to Transfer Pricing has taken cue from the OECD guidelines and evolved a long way to prevent associated enterprises from evading taxes, it still needs a few changes and amendments to deal adequately with the Double Irish Dutch Sandwich. Some of the changes that the author proposes are as follows.

6.1. Applicability of the Profit-Split Method in case of intangibles

[46]Convergys Customer Management Group Inc. v. Assistant Director of Income-tax (International Taxation), Circle-1(1), New Delhi [2013] 34 taxmann.com 24 (Delhi – Trib).

[47]Director of Income Tax (International Taxation) v. Morgan Stanley and Co., [2007] 162 TAXMAN 165 (SC), CIT v. Hyundai Heavy Industries Co. Ltd., (2007) 291 ITR 482 (SC), Convergys Customer Management Group Inc. v. Assistant Director of Income-tax (International Taxation), Circle-1(1), New Delhi [2013] 34 taxmann.com 24 (Delhi – Trib).

The success of any modern day corporation is to a large extent contingent on technological innovations. It is because of this reason that Intellectual Property assets are far more valuable than tangible assets these days. Both the OECD guidelines and the Indian Income Tax Rules, 1962 say that Profit-Split Method is usually the most preferred method in case of intangibles. However, the government vide its circular 5/2013 withdrew an earlier circular which made Profit-Split the most preferred method in case of intangibles. The reason given was the apparent hierarchy that the circular seemed to create. Since, the Double Irish Dutch Irish Sandwich is particularly effective in case of intangibles;the problems posed by it can be solved if Profit-Split Method is compulsorily made the most-appropriate method in case of intangibles.Cost-Plus Method is the most-appropriate method in case of specialised goods or long-term buy and supply agreements and the Resale Price Method is the one used in case of distribution activities. Hence, there already exists some kind of hierarchy among the various methods available to calculate the arm's length price. Thus, withdrawing the circular just because it seemed to create some sort of hierarchy among the various methods is off the mark.

6.2. Clarifications regarding Research and Development Centres

Another flaw in the existing legal framework on Transfer Pricing is the lack of clarity to identify research and development centres. As mentioned above, the company using the Double Irish Dutch Sandwich can very easily avoid tax by contending that it is a contract research and development centre with limited risk. The guidelines mentioned in Circular 6, dated 20/6/2013, to identity R&D centres are not cumulative.[48] That means that the Indian R&D centre may own the intangibles but may still be classified as a mere contract R&D centre. Making the guidelines cumulative will be a bit restrictive for the companies but preventing tax avoidance should be given preference even if leads to hardships for a few companies.

6.3. Cancellation or breach of Advanced Pricing Agreements

[48]Income Tax Department, *Circular No.*06/2013 [F NO. 500/139/2012], available at http://www.incometaxindia.gov.in/_layouts/15/dit/pages/viewer.aspx?path=http://www.incometaxindia.gov.in/communications/circular/910110000000000665.htm&k=&opt=&isdlg=0 (last accessed on 28 August 201 3).

Matter would have been ten times worse had the revenue signed an Advanced Pricing Agreement with the assessee. As mentioned above, an Advance Pricing Agreement is binding on both the parties and the revenue can unilaterally cancel it only if there is fraud or misrepresentation on part of the assessee. However, the provisions related to Advanced Pricing Agreement do not clarify the appropriate remedy available to either of the parties in such a case. Assuming that an Advanced Pricing Agreement is unilaterally cancelled by the revenue, would an appeal lie with the Income Tax Appellate tribunal or would ordinary courts have jurisdiction? Further, can either of the parties to the agreement ask for specific performance or damages in case of breach? These are some of the questions left unanswered by the current legal framework. The author thinks that these matters need to be clarified in order to make the APA scheme more viable and beneficial for both the parties.

INTERACTION BETWEEN INTERNATIONAL TAXATION AND PRIVATE INTERNATIONAL LAW

- **Dipti Bajaj***

ABSTRACT

International Taxation refers to an independent branch of law that has been roughly defined as a body of legal provisions embedded in the tax laws of each country to cover the tax aspects of cross border transactions. Sovereign states with varied tax systems have independent tax regulations, which can sometimes coincide with methods of taxation of other jurisdictions leading to injustice. The most knowing international tax conflicts include double taxation, tax heavens, indirect transfers, transfer pricing, off-shore derivative instruments. Pith of international tax law lies in the relief to such conflicts provided for in the municipal tax law itself, cases decided by that country's judiciary, appropriate amendments to tax and other laws to deal with contemporary international tax issues etc. One way of interpreting international taxation is that it is the aggregation of those national law/rules triggered by conflict of tax laws occurring from each state's sovereignty due to diversity or duplication of law of each state's internal tax laws. Broader sense of the term shall include national as well as international tax laws dealing with problem of fiscal jurisdiction, i.e. law of conflict resolution arising from collision of various tax systems through international customary law, treaties etc.

This paper concentrates on former part of the interpretation of the term which inclines international taxation towards Private International Law rather than Public International Law as the governments usually limit their scope of taxation on the basis of territoriality, residency or exclusionary system or a hybrid system with such all or some of these characteristics. Private International Law determines which country law should be refers to in cases where there are international factors involved, in order to solve contradiction of the private law of each country. The relationship between these two branches of law has been established through the medium of conflicts

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like double taxation, tax heavens, undisclosed international assets etc., the attempted solution to which has been provided by municipal legislations, judgements and amendments to existing legislations. The paper attempts to take cognizance of and explains relevant legislations along with latest amendments and enactments (Including prospective enactments) for e.g. Black Money Act 2015, Finance Act 2015, GAAR etc.

1. INTRODUCTION

The concept of international tax law happened to have originated from conflict of tax laws of different nations. Sovereign states with varied tax systems have independent tax regulations which can sometimes coincide with methods of taxation of other jurisdictions leading to injustice. The most knowing international tax conflicts include double taxation, tax heavens, indirect transfers, transfer pricing, off-shore derivative instruments. Pith of international tax law asserts that the relief to such conflicts is provided for in the municipal tax law itself, cases decided by that country's judiciary, appropriate amendments to tax and other laws to deal with contemporary international tax issues etc. One way of interpreting international taxation is that it is the aggregation of those national law/rules triggered by conflict of tax laws occurring from each state's sovereignty due to diversity or duplication of law of each state's internal tax laws. Broader sense of the term shall include national as well as international tax laws dealing with problem of fiscal jurisdiction, i.e. law of conflict resolution arising from collision of various tax systems through international customary law, treaties etc.

This paper concentrates on former part of the interpretation of the term which inclines international taxation towards private international law rather than public international law. In the former international tax law identifies collision in national tax systems and attempts to rectify the same through municipal law itself. [1] These are rules established by national law relating to international finances for instance in India, Income Tax Act 1961 (IT Act) unequivocally provides for transactions having international ramifications say case concerning income earned by a resident abroad or by a NRI in India, the Act taxes both, former under the worldwide principle and the latter under source principle (Section 5). Other contemporary tax issues with international element are dealt with

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1 http://revcurentjur.ro/arhiva/attachments_201104/recjurid114_11F.pdf(last accessed on 8 September 2015).

by judicial decisions, amendments to IT or other Laws. Objectives of international taxation include contribution to local public services, prohibition of tax avoidance, and principle of burden sharing, prohibit harmful tax competition.

2. International Taxation and Private International Law

Private International Law determines *which country's law should be referred to in cases where there are international factors involved, in order to solve contradiction of the private law of each country*.[2] If a private transaction falls within the scope of legal orders of more than one state, Conflict of Law rules or Private International Law determines which law applies. Unlike Public International Law, there happens to be no uniform system of Conflict of Law, each State has its own rules. Ergo, imperfect legal relationships and consequential differing results are unavoidable. This Conflict of Law determine which law applies even when such question arises in tax matters (to the extent relationship is based on private law) e.g. when and whether a taxpayer has gained beneficial ownership of an asset, pricing between multinational associated enterprises, residence of an individual or a corporation etc.[3]Usually, states levy taxes only on the basis of their own tax laws but in certain circumstances recognition (not necessarily implementation) to foreign tax laws are given either through DTAA or providing foreign tax credit to the tax payer. As far as treaty rules are concerned, unlike rules of Private International Law. International Tax Law does not lead to application of foreign Law owing to the assumption that both the contracting states tax according to their own law. They are more in the nature of "*rules of limitation of law*" rather than "*conflict of law*". They have their independent origin and legal foundation separately from the domestic tax law (falling under the realm of Public International Law).

"International taxation is a body of legal provisions embedded in the tax laws of each country to cover the tax aspects of cross border transactions."[4] It is basically determination of tax liability of a "*Person*" subject to the tax laws of different countries or rather the international aspects of the individual country's taxation laws. The governments usually limit their scope of

2 https://www.pwc.com/jp/en/taxnews-estate-taxation/assets/private-international-law-e.pdf(last accessed on 25 September 2015).

3 http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1039&context=bjil (last accessed on 15 October 2015).

4 https://www.icsi.edu/docs/webmodules/Publications/4.%20Tax%20Laws%20and %20Practice.pdf(last accessed on 12 September 2015).

taxation on the basis of territoriality, residency or exclusionary system or a hybrid system with such all or some of these characteristics. Such systems of taxation can lead to double taxation, no taxation, re-characterizing of income by the tax-payer to favourable jurisdiction in a manner that can reduce his tax liability (transfer pricing), taxing/ no taxing of world-wide income etc. Most countries provide for rules within its own municipal law to resolve such conflict of law issues, which can, in a way be referred to as Private International Law Rules.

For instance, as mentioned above, it contains provisions to deal with transactions having extra-jurisdictional ramifications. For e.g. taxing of incomes earned abroad by resident tax-payers or income earned by Non- Residents in India under Section 5 of the Act.

3. MOST COMMON CONFLICTS OF THE INTERNATIONAL TAXATION

3.1. Double taxation

National tax law establishes connecting factors between taxpayer and the taxing state such as residence, habitual residence, citizenship, family ties (personal factors) or source of income, place of activity, location of property (economic factors). Overlapping in the multiple jurisdictions can occur when different connecting factors determine the tax liability for the same subject leading to double taxation. If the states have DTAA, naturally that will apply but in case it doesn't exist, the municipal law shall come to the rescue. Now the difference in approach of different legal systems in taxing any income under its sovereign authority can be noticed under the following examples:[5]

i. Cayman Islands, Maldives, Kuwait, Bahrain etc. - No Personal Income Tax whatsoever.
ii. Costa Rica, Lebanon, Botswana, Singapore etc. - Territorial Taxation only i.e. no Foreign Income of resident assessees chargeable to tax under the domestic law.
iii. Australia, Canada, France, Germany, India etc. – Residential Taxation.
iv. United States and Eritrea - Citizenship based taxation along with residential taxation i.e. Citizens are taxed same as residents.

[5] http://www.ey.com/Publication/vwLUAssets/Global_Executive_2011/$FILE/GE 2011_Global_Executive.pdf(last accessed on 1 September 2015).

Territorial systems usually tax local income irrespective of the taxpayer worldwide income which leads to potential avoidance of taxation on portable income by moving it outside his home country. Residential systems like India have to undertake the daunting tasks of defining '*resident*' and characterizing the non-residents' income, which varies from country to country. The test for residence acting as one of the connecting factors to determine tax liability of an individual for an individual has been mentioned under section 6 of the IT Act (Residents, Non- Residents, and Not Ordinarily Residents). It is based on the number of days a person has been residing in India in the previous year or years before. For corporations the test of residence has been recently changed by the Finance Act, 2015. From this year onwards, a company will be considered to be resident if it is incorporated in India or if it's Place of Effective Management (POEM) is in India. Earlier, test of control and management wholly in India was used. Thus if part of control was outside India even though it was largely controlled from India, it would not be considered a resident of India which led to avoidance of tax on global income by such companies under the IT Act. This could be achieved simply, by say, having one or more foreign directors and board meetings outside India. Various judicial pronouncements have laid down that this control and management refer to de-facto control and management and not the rights to control and manage.[6] Now, place where key management and commercial decisions necessary for the conduct of business of an entity as a whole are made in substance will be considered the place of residence for that company for the purposes of Indian IT Act.[7] Also, section of the IT Act categorically mentions that if a person is resident in India in a previous year relevant to an assessment year in respect of nay source of income, he shall deemed to be resident in India in the relevant assessment year in respect of each of his other sources of income i.e. not only his India sourced income but also his worldwide becomes taxable in India. Under the IT Act, they will have to file their tax return and disclose assets. Indian IT Act also provides for taxing of any payment that has to be made to a non- resident, the resident tax payer is obliged to deduct tax at source and pay under section 195 of IT Act at the rates as specified by the CBDT. For e.g. dividends paid by domestic countries – NIL, for royalties and technical services- 10% etc. It does not apply to non-resident tax payer or to payments made outside India by one foreigner

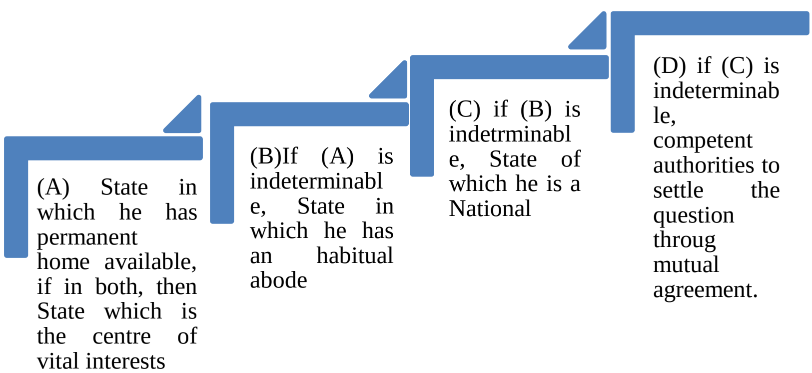
[6]CIT v. Bank of China,(154 ITR 617) (1985).

[7] http://www.rashminsanghvi.com/downloads/taxation/internationaltaxation/Budget 2015_Direct_Tax_and_FE MA.htm(last accessed on 14October 2015).

to another even if the other has rendered services in India this is because a country does not recognize or enforce revenue laws of another unless they have agreement of such nature[8].

To mitigate the double taxation of income the provisions were made which extend relief in two ways- unilateral and bilateral (section 90[9] - through treaty). In case where an individual happens to be a resident of both the contracting states based on their domestic tax law, double taxation avoidance agreements actuate which country's tax law shall apply by ascertaining the actual residential status of a person in the following manner[10]:

Person shall be *Resident* of only that State[11]-



And in case of person other than individual, determination shall be made based on situation of POEM. These rules are referred to as '*tie breaking clause*' which apply when the concerned person is resident of more than one state. But, the treaty provisions are also applicable when a person is resident in one country but has a source of income situated

8 http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Articles/Groping%20in%20the%20Dark%20%20The%20Extending%20Arms%20of%20the%20Indian%20International%20Withholding%20Tax.pdf(last accessed on 30August 2015).

9 The Central Government can enter into an agreement with Government of any other Country for granting relief to the assessee having to pay tax under Tax laws of both the Countries to avoid double Taxation, exchange of information for the prevention of evasion or avoidance of income tax chargeable under Tax Laws of the contracting States.

10 https://www.icsi.edu/docs/webmodules/Publications/4.%20Tax%20Laws%20and%20Practice.pdf(last accessed on 11 September 2015).

11 Based on OECD guidelines

in another country, leading to a situation at hand where his income is taxed in both countries i.e. double taxation occurs. For example, Article 1 of India- US DTAA mentions that it is applicable to persons who are residents of one or both of the contracting states.

Section 91 applieswherethereis no agreementunderSection 90 forrelieforavoidance of doubletaxation of incomewhereinbydeductionorotherwise, he shall be givenreliefundertheIndian IT Actitself i.e. domesticlaw of the country willapply. He isentitledtoclaimdeductionfromthetaxpayablebyhimonsuchdoublytaxedin come at ratelower of eitherthe actual taxpaid in theforeign country oramountcomputedundertheIndian IT Act. Thisreliefisavailableto non-residentassesses, butonly in respect of theirincomefrom a firmregistered in India and resident in India. As far as DTAA withtaxheavensisconcerned [12]. India's DTAA withTaxHeavenslikeMauritius, Cyprus, havefacedcriticismespeciallythe capital gainsreliefprovision. Itispivotaltomentionherethat in 2013, CBDT issued a pressrelease [13] notifyingCyprus as a non-cooperativejurisdictionforfailuretoprovideinformationwhichwasrequestedforunderthe Exchange of Information ("EoI") provisionsunderthetaxtreatybetween India and Cyprus. Followingthenotification, itwasclarifiedthatthoughthe DTAA has notbeenterminated, itsbenefitshavebeen, to a largeextent, done awaywithincluding no deductionsforanypaymentmadetofinancialinstitution in Cyprusorforanyexpenditurearisingfrom a transactionwith a personlocated in Cyprusunlessthetaxpayerfurnishestherequisiteinformation.Singaporethoughpermitsforeignersto set up companiesthere, levies no capital gains and incometaxonforeignprofitsdespite anti abuse rules in the India-SingaporeTreaty. ThemostinfamousisIndia's DTAA with UAE whereinthereis no incometaxwhatsoeverforindividuals, subjecttoconditions, which can possibly lead tostashingaway of unaccountedmoneyfrom India.[14]Thoughgovernmentisundertalksforrenegotiation of suchtreaties. Fore.g. Mauritiustopreventthe abuse of the beneficial provisions of DTAA and facilitatetheexchange of informationbetweentheparties. In

[12]Has been explained later in the paper.
[13]Notification No. 86/2013 dated November 1, 2013
[14]www.rashminsanghvi.com. Presentation on Tax Haven

thepastfewyears, enteredintoseveralEoIagreementswithothercountries, especiallythetaxheavens, tocheckevasion. Recently, thegovernment has alsosigned multilateral automaticexchange of information (AEOI) forsharing of tax data and has enteredanagreementwiththe US undertheForeignAccountTaxComplianceAct (FATCA) which willenable India togetinformationaboutfinancialtransactions done byIndianpersons in othercountries.[15]

Theintroduction of many anti- abuse provisions in thenationallaw as well as treatyprovisions has rootedfromthe case of AzadiBachaoAndolan [16] in whichtreaty shopping [17] wasthekeyissue. TheSupremeCourtwhileobservingthatthe central governmentunderSection 90 can tax/grantexemptions, upheldthevalidity of Circular No. 682 providingfortaxing of capital gains of anyresident of Mauritiusbyalienation of shares of anIndiancompany in Mauritiusonly. ItfurtherheldthatLimitationonBenefits ("LOB") clauseismustiftheintentionistopreventtreaty shopping. Pursuanttothisjudgement, theIndianTaxauthoritieshavetaken up toensurethat bilateral taxtreaties are notusedforabusivebusinessarrangements. In 2015, India-Mauritius DTAA has beenrevisedtoincludean LOB clause. Presently, India has comprehensiveTaxTreatieswitharound 88 countriesout of whichonethirdhaveArticleon LOB afterthereportaddressing BEPS (Base Erosion and ProfitShifting) wasissued in February 2013. LOB provisions are aimed at denyingtreatybenefitsfor a transactionifitsmainpurposewastoobtainbenefitsundertherespectivetaxtreaties. Thisisusuallyexaminedbasedonallfacts and circumstances, of whether in theabsence of suchtaxadvantages, a reasonabletaxpayerwouldhaveenteredintothesametransactions/ arrangements. SuchclausesalsoindicatethatdomesticlawwouldoverridetheTreatytopreventtaxavoidance.

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15 Jayant Sinha, *Black Money Finance*, The Economic Times, availaible at http://articles.economictimes.indiatimes.com/2015-07-0/news/65036832_1_blackmoney-finance-jayant-sinha-tax-information-exchange-agreements (last accessed on 12 October 2015).

16 Union of India v. AzadiBachaoAndolan,(2003) 132 TAXMAN 373 (SC).

17 Re- routing of funds from non- contracting State through one of the contracting States to benefit from the Tax Treaty provisions between the two contracting States.

3.2. Tax heaven

OECD very well recognizes that every sovereign jurisdiction has a right to determine whether to impose direct taxes on income and if so then to determine the appropriate tax rate[18]. Also, countries are usually not obligated to provide customer information to tax authorities abroad. In simplest of terms, a tax heaven country is a place where income is taxed at a lower rate or there is no tax at all because of which '*persons*' move from jurisdiction of high rates of taxes to a region where tax liability is lower. This has perpetrated aggressive competition amongst various nations to lure international investments in their country, especially amongst small countries, thereby making '*tax heaven shopping*' available to multinationals. Obviously, this adversely affects the tax revenue of the Country from where such '*persons*' transfer their business. Switzerland is the most infamous tax heaven followed by certain Caribbean countries. They also tend to facilitate domestic tax evasion[19] and money laundering through strict financial secrecy laws. [20] Other Factors determining whether a jurisdiction is a tax heaven – lack of transparency, prevention of effective exchange of tax related information etc.

Tax heavens may have reputable banks to attract business and customers' accounts therein are required to pay taxes in that region even though they are not the citizens/residents of such countries. The taxes paid here are much lower than they would have had to pay in their home country which can lead to considerable amount of saving in the long term. People use these tax heavens to hide their income generating investments, due to non- disclosure, they can avoid paying taxes on that income. It is imperative to mention here that this idea of low taxes, high privacy is not illegal. What is illegal is the failure to report income from foreign accounts to the tax authorities back home in accordance with domestic tax law. Indian jurisprudence deal with unaccounted money and illegal income through legislations covering following transactions with foreign element having repercussions on Indian taxation (with recent updates brought by Finance Act, 2015):

[18] http://www.igidr.ac.in/money/mfc-12/Manish_Shashank.pdf(last accessed on 18 September 2015).

[19] Avoidance of taxes which otherwise have to be paid to home Country by allowing taxpayers to reallocate taxable income from high to low tax jurisdiction.

[20] Richard A. Johnson, *Why Harmful Tax Practices Will Continue After Developing Nations Pay: A Critique of the OECD's initiatives against harmful tax competition*, 26 Boston College Third World Law Journal 351 (Spring 2006).

3.2.1. Undisclosed foreign income and assets

Before 2012, there existed a clear void in Indian law as disclose of foreign assets was not a requirement under Income Tax Returns filed by the Assessee. Also, Wealth Tax Act did not cover within its ambit disclosure and taxation of productive financial assets which could have possibly perpetrated stashing away of black money in the form of shares in foreign company, foreign bank account, international securities etc. undisclosed and unaccounted for especially in tax heavens. Finance Act 2012 changed this scenario following numerous leaks of tentative figures of the amount of black money stashed abroad by Indian Residents by mandating the residents to file return of their foreign assets under Schedule FA whether or not they had taxable income under the Act. After years of lackadaisical approach of the previous Government, the new government finally came up with much controversial Black Money (Disclosure of Foreign Income and Assets) Act, 2015.

The Act shall apply to all persons who qualify to be a '*resident and ordinarily resident*' as under Section 6 of the IT Act. It proposes to levy a tax of 30% on the total undisclosed foreign income and Assets of a person in a year. The total undisclosed foreign income and asset in a year is the income from a source outside located India that has not been disclosed in the return or where the Indian tax return is not filed and the value of undisclosed asset (held by assessee in his name/beneficial owner/beneficiary). These undisclosed assets are to be taxed on their Fair Market Value in the previous year in which the Asset came to the notice of the tax authorities. The penalty can be levied upto 3 times on the tax amount i.e. 120% alongwith the risk of prosecution which can be rigorous imprisonment from six months to seven years for failure to furnish returns in respect of Foreign Assets/income. The punishment for wilful attempt to evade tax w.r.t. foreign income/asset will be rigorous imprisonment from three to ten years in addition to fine.[21]

3.2.2. Money laundering

Money laundering is concealing of the proceeds generated out of a criminal activity in order to disguise its origin and make it seem like it was generated through legit means. Offshore tax heavens have long been associated with money laundering owing to their stringent financial

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21 http://pib.nic.in/newsite/PrintRelease.aspx?relid=117477(last accessed on 4 September 2015).

secrecy laws which prohibit disclosure of anonymous accounts to tax authorities abroad. A hypothetical situation can be considered to understand how tax heavens in a way promote and protect money laundering. If a high stature government employee is taking bribe or steals substantial wealth from government funds, obviously, he will not be able to hold this huge amount in his name in his domestic bank account. So he might open an offshore company in tax heavens, the payers of illegal monies will directly transfer the sum to the company's account without payee's name appearing on any of the financial document/ instrument. The company will become a veil covering his name. Tax heavens laws provide for secrecy which along with the system of '*Bearer Shares'* [22] prevent leaking of account holder's information.

In India, Prevention of Money Laundering Act, 2002 (PMLA) attempts to curb money laundering and provides for seizure, confiscation and freezing of the proceeds of the criminal activity. The Act also empowers the Enforcement Directorate to confiscate the Indian property of equivalent value of foreign assets in case it finds it difficult to bring the funds back to India. Also, Finance Act, 2015 has made tax evasion relating to foreign assets and income a predicate offence under the Act i.e. unaccounted money or undisclosed assets abroad will now be considered a main and serious criminal offence under PMLA along with the penalty under the IT Act. [23]

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[22] *Ibid.*

[23] http://www.rashminsanghvi.com/downloads/taxation/internationaltaxation/Budget_2015_Direct_Tax_and_FEMA.htm(last accessed on 26 September 2015).

3.2.3. FEMA provisions

Finance Act 2015 has also inserted Section 37A in FEMA which that if any person holds any property, security of foreign exchange abroad contravening Section 4 of FEMA, an equivalent value of Indian Property can be seized by the Enforcement Directorate without any notice or opportunity of proving to the tax payer. This is because in case a person holds assets in a tax heaven in violation of Section 4 and when the ED wants to confiscate his foreign assets, the government or its banks may refuse to cooperate owing to their secrecy rules, ergo, ED is given power to go after his domestic assets. It will deemed to be black money. Also the order will be non-appealable under FEMA, only Writ jurisdiction to the High Court.

3.2.4. Transfer pricing

As mentioned earlier, tax heavens help people to hold wealth safely and incognito. Tax planners are concerned about how to transfer the funds outside their home country to a tax heaven to hold and own the same safely and utilize it without actually breaking the law. Shifting of trading profits can be done through transfer pricing. Transfer pricing is undertaken between associated enterprises or related enterprises associated by reason of common ownership, control or interest wherein an entity in a high tax jurisdiction like India under invoices its incomes and over invoices its expenses and shifts the resulting profits to a tax heaven where its associated enterprise is located. Pricing of products is the key in the scenario to transfer taxable profits from taxing country to a tax heaven.

Example: A U.S. Co. gets its raw material from other countries where it has subsidiaries. Also the company has subsidiaries in tax heavens like Malaysia, Panama etc. Now, the subsidiaries will sell their finished products (to be used by the US Co. as raw material) to group's tax heavens at the lowest profit margin. Tax heavens will sell the same goods to the US Company at highest profit margin. US Co. will have to pay several other expenses like interest, royalty etc. to group's tax heavens. That way, substantial profits of the group can be retained in tax heavens. Profits will remain same for the group as a whole, it's just the group reduces its overall tax liability.

In India too, there was a need to develop a mechanism to determine fair and equitable profits and taxing them in India. So, Finance Act 2001 brought detailed transfer pricing provisions in India through Section 92 to 92F of the IT Act. These provisions provide for determination of transfer price and documentation procedure. Finance Act 2012 extended the applicability of transfer pricing to certain domestic transactions (Section 92BA) [24] . The aim of these provisions is that price of goods/services transferred between the related enterprises (transfer price) should be at arm's length price.[25] Price more or less than the arm's length price can result into uncompetitiveness of the product due to high cost or loss at an entity level respectively. The term associated enterprises has been defined under Section 92A of the IT Act, the pith of the section is that Associate Enterprise can be determined on the basis of control, capital or participation in management of one entity over the other. It is to be noted that the participation can be direct or indirect. Section 92(2) elucidates instances of Deemed Associated Enterprises. International transaction has been defined as transaction between two or more associated enterprises, at least one of whom is a NR having bearing on their profits, losses, income, assets etc. including their mutual agreement for contribution, allocation or apportionment of any cost or expense w.r.t. any benefit/service provided to any of such enterprises. Transactions can also deemed to be International between such Associate Enterprise looking at the substance of their relationship. Section 92CA calls for reference to the Transfer Pricing Officer by the AO for the computation of ALP in an international transaction. He can call for information from the Assesse, can proceed *suomoto*, discover, inspect, call for attendance, etc.

It is pivotal to mention here that transfer pricing continues to remain as one of the significant challenges faced by the foreign investors.[26] Off late, more complex issues that are debated include cost sharing for market intangibles, share valuation etc.[27]

i. Market Intangible: An increasing number of MNEs tap the Indian markets by offering their products through Local affiliates/distributors. Owing to strong market competition, there

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[24]E.g. Transactions between related parties, other parties having substantial interest.

[25] ALP- Fair price of goods/ services chargeable from an independent party in uncontrolled conditions

[26] http://www.pwc.in/services/tax/news_alert/2013/pwc_news_alert_5_july_2013_transfer_pricing_perspectives_recent_judicial_developments_on_significant_issues.pdf(last accessed on 20 September 2015).

[27] http://puneicai.org/wp-content/uploads/HDG-ICAI-Pune-Transfer-Pricing-Latest-Developments-4-July-2015.pdf(last accessed on 5October 2015).

has been substantial increase in AMP (Advertising, Marketing and Promotion) expenditure incurred by the Indian licensee on behalf of its foreign AE which has brought key transfer pricing issue in intra group transactions relating to the creation of market intangible and the taxability of associated income [28]. In LG Electronics case [29], Delhi SB ruled that tax payer's use of brand/logo of its AE outside India coupled with AMP expenditure higher than industry average is basically a tacit agreement between the parties for promoting the foreign brand and same can be considered as provision of service to AE by the tax payer [30]. The same was to be treated as an international transaction, calling for applicability of Transfer Pricing Regulations. This position led to a lot of ambiguity which was finally clarified last year in the case of Sony Ericsson[31] wherein the Delhi High Court held that AMP expenses can be characterized as International Transaction subject to transfer pricing but it rejected the concept of bright line test suggested in LG test and that non-routine AMP may not necessarily be considered a separate transaction. Marketing and distribution expenses can be clubbed for ALP determination as they are closely linked. High Court said brand building is not equivalent to advertisement even though latter is exorbitant [32]. The Court stated that transfer pricing provisions are anti- avoidance provisions, should be appointed selectively so as to they don't lead to double taxation.

ii. Share Valuation: Recently Bombay High Court in Shell India Markets case [33] following its decision in Vodafone [34] held that transfer pricing provisions do not apply to capital amounts received or arising on account of issue of shares by an entity to a

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[28] http://www.tp.taxsutra.com/microsite/AMP#content-bottom(last accessed on 11 October 2015).

[29] LG Electronics India Pvt Ltd v. ACIT, [2013] 29 taxmann.com 300 (Delhi-Tribunal)(SB).

[30] https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/taxnewsflash/Documents/tp-india-march19-2015.pdf(last accessed on 28 September 2015).

[31] Sony Ericsson Mobile Communication India Pvt. Ltd. v. CIT, (ITA No. 16/2014)-Taxsutra.

[32] http://www.pwc.in/assets/pdfs/news-alert-tax/2015/pwc-news-alert-18-march-2015-delhi-high-court-on-marketing-intangibles.pdf(last accessed on 21 August 2015).

[33] Shell India Markets Pvt. Ltd. v. ACIT LTU and ors (Writ Petition No. 1205 of 2013 – Bombay High Court).

[34] Vodafone India Services Pvt. Ltd. v. UOI, (2014) 368 ITR 1 (Bom)

non-resident entity. This is because 'income' should arise out of International Transaction which is chargeable to tax and Income does not include capital account transaction. Thus, there is no charge on transaction of issue of share at a premium (capital in nature). Moreover, Chapter X is a not charging provision but a machinery to arrive at ALP between AE. Mere non reporting of transaction in form 3CEB would not give jurisdiction to tax department to tax a non- taxable transaction.[35]

3.2.5. Offshore transfers comprising Indian assets

The mechanism followed to shift Capital gains from indirect transfer of Assets in India away from India is that the Parent Co. /Individual holds assets in the Host country through a subsidiary Company/SPV (ABC). These shares in SPV are held through a tax heaven entity (EFG). Whenever transfer of interest in ABC is desired may be due to substantial increase in the value of business, the same is achieved through EFG i.e. Transfer of shares of EFG. No tax will be payable in India as no transaction has been directly occurred or recorded in India In simple terms, situs of the title documents is shifted outside the host country to avoid taxes in the host country as judiciary goes by form and not substance as in case of Vodafone International. The Supreme Court in this a case put an end to a long dragged controversy surrounding the taxability in India of offshore transfer of shares of a company (in Cayman Islands) by the Hutchison group to Vodafone.[36] The Court came to a conclusion that there existed no tax liability on Vodafone as Indian tax authorities do not possess territorial jurisdiction to tax the off- shore transaction in the stated facts. Tax department was directed to return INR 25000 collected by it as tax earlier. While interpreting Section 9(1) (i) of the IT Act[37], the Court observed section does not cover indirect transfers of capital asset which can also be noticed from perusal of Direct Taxes Code Bill 2010 proposals. As for the applicability of Section 195 (Withholding tax), the Court held that TDS would not arise as the case involves offshore transfer between two non-

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[35] https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/taxnewsflash/Documents/india-dec-8-2014.pdf(last accessed on 17 September 2015).

[36] https://www.kpmg.com/in/en/services/tax/flashnews/kpmg-flash-news-vodafone-international-holdings-bv.pdf(last accessed on 8 September 2015).

[37] Section inter alia says that income accruing/arising directly or indirectly from transfer of a capital in situated in India is deemed to arise/ accrue in India in the hands of the transferring non- resident.

residents, thus no liability to pay capital gains tax in India. Also Vodafone cannot be treated as representative assessee of HTIL. The Court asserted if NR, through abuse of organizational form makes indirect transfer to avoid tax/ withholding tax, the tax authorities can disregard this form of arrangement and characterize the equity transfer according to its economic substance and impose tax.

It is pivotal to mention here that this impugned judgement was in a way held to be moot by insertion of explanation 2 to Section 2(47) with retrospective effect from 1962 by Finance Act 2012 which clarified that '*transfer*' included parting with/creation of asset in India directly/indirectly through a Share Purchase Agreement or otherwise, notwithstanding that such transfer has been effected through transfer of shares of a Company registered/incorporated outside India and shall be subjected to tax in India. The amended provisions (Explanation 5 to Section 9(1)(i) provides that capital asset (share/interest in foreign entity) shall be deemed to be situated in India if the share derives directly/indirectly, its value substantially from assets located in India. Finance Act 2015 has extended clarification to the term '*substantial*' as the value of Indian assets (tangible/intangible) exceeding INR 100 million and representing at least 50% of the value of all the assets held by the foreign entity. If all the assets of foreign entity are not located in India then capital gains tax is proposed to apply to only such part of income as is reasonably attributable to the Indian assets. The Act also mentions case where indirect transfer provisions would not apply.

The Indian government has attempted to curb the tax evasion by residents through tax heavens by enacting plethora of national laws some of which have been mentioned above in brevity and by entering into bilateral tax agreements containing anti abuse provisions with such nations respectively. One classic example, which can be illustrated, would be of India-Singapore DTAA. Singapore was considered to be a downright Tax Heaven owing to its territorial system of taxation and even because the Limitation of relief – article 24 of the India- Singapore DTAA exempted from its purview capital gains which led to tax evasion from India. The position changed after the treaty was amended in 2005 which made it taxable under Singapore tax law and exclusion of the benefits to shell/conduit companies which have been elaborately defined under the DTAA and also LOB clause was included in the revised bilateral agreement. Thus, the Indian government is continually on a look out and attempts to plug loop-holes in domestic tax laws as well as international treaties to curb non-disclosure of income and erosion of tax payable in India.

4. TAXABILITY OF OFFSHORE DERIVATIVE INSTRUMENTS (ODIS)

Sometimes, it is difficult to ascertain the actual owner of the underlying asset, the actual possessor of the real entitlements/ benefits/ benefits accruing from such ownership though he does not hold legal title to the same (substance over form approach). This usually happens in the case of Offshore Derivative instruments leading to deferral of taxes in the resident country. Tax Authorities aim to prevent the tax avoidance by looking at the beneficial owners under the garb of conduit structures. ODIs have been defined under SEBI (Foreign Institutional Investor) Regulations, 1995 as instruments, which are issued outside India by a FII against underlying securities held by it (listed/proposed to be listed in Indian Stock Exchange). E.g. Participatory Notes, swaps, options, contracts for difference etc. In the absence of unequivocal tax provisions, it becomes difficult to determine who is the beneficial owner whether the issuer long party holding the securities situated in the source country and has hedged his position by issuing derivative instruments against such securities/assets or the recipient party i.e. holder of the derivative instrument. Holder of an ODI is only entitled to the returns on the underlying securities with no rights in such securities because their ownership and other similar attributes vest with the FII. Unlike in few international precedents, Law in India is not very clear to make such holders, beneficial owners of such securities taxable under the Income Tax Act as it is not mandatory for FII to hedge his position, no voting right to the holder, holder cannot instruct FII to sell the underlying securities etc. The value of ODI can be linked to an asset in India (security from which swap derives its value), it is a nonetheless a contract that does not really obligate FII to acquire/dispose such security i.e. he may not fully hedge its position vis a vis the counterparties. On redemption of ODI by FII, holder is entitled market price plus dividend (no requirement to sell securities by FII). Holder having no control on securities should not be perceived as share/interest deemed to be situated in India under Explanation 7 to Section 9(1) (a). Thus, there exists a clear void in Indian tax law as far as taxability of offshore derivative instruments is concerned despite capital gain tax amendments brought by Finance Act 2012.

5. NEED FOR MAT (MINIMUM ALTERNATE TAX)

A company is supposed to pay tax in accordance with IT Act provisions but its Profit & Loss Account is prepared as per the Companies Act provisions. Certain companies show book profits, declare dividend but shows nil income under the IT Act and thus referred to as zero tax companies due to large number of exemptions deductions under the Act. Section 115JA states companies paying normal income tax less than 18.5% of book profits on account of various deductions/exemptions under the Act, it has to pay MAT at 18.5%. Controversy relating to applicability of MAT on foreign companies especially FII/FPI has been settled by Finance Act 2015 which clarifies that MAT provisions would not apply to income accruing to foreign companies (including FII/ FPI) from capital gains from transaction in securities/interest/royalty/FTS FY 2015- 16 onwards. Also, pending cases prior to April 1, continued to be under the tax radar till it was subsequently clarified by the government that such transactions shall also not be taxed. Also, the Finance Act 2015 has settled the long dragged controversy of taxability of AOP under MAT provisions. There was conflict of Company Law and Income Tax Law, former stated that AOP members are not taxable on share of their profit in AOP but the latter included this share of profit in book profits leading to a situation had to pay MAT after AOP has already paid the tax which has been negated by the 2015 Act. For FIIs also MAT has been removed. Though it seems both these amendments have been given prospective effect, though the amendments are clarificatory in nature.

6. GENERAL ANTI AVOIDANCE RULES (GAAR)

GAAR is an anti- tax avoidance rule introduced in 2012 Budget by the then Finance Minister to counter aggressive tax avoidance schemes. Enactment of these rules shows how India is moving slowly though surely towards substance over form taxation and legitimate business planning.

i. Transaction/arrangement having no commercial substance other than evading tax can be denied tax benefits by the empowered officials.
ii. Target Participatory Notes (hedging of funds not registered with SEBI, Investment I Indian securities by anonymous foreign holder of derivative. So far, tax would only be imposed on the holder of securities (registered financial firm) who buys securities

on behalf of the client.[38] The investor has to prove that the respective Participatory Note is not undertaken to avoid taxes.

iii. Tax Department could deny double taxation treaty benefits to foreign funds if deals are made in tax heavens like Mauritius to avoid taxes.

These rules signify tough stand the government is willing to undertake to crack down tax evasion. The domestic Law expressly provides that GAAR provisions would override all tax treaties so as to give wide powers to the tax authorities to look through/disregard/re-characterize transactions having tainted elements like- not at ALP, abuse of tax provisions, not in an ordinary employed bona fide manner etc. Invocation of GAAR can have far reaching ramifications for foreign investors in India. But the guidelines explaining aspects of GAAR, circumstances in which it can be invoked, its application etc. is awaited[39]. The rules were introduced in 2012 but the announcement spooked foreign Investors and the rules were widely criticized, due to its negative publicity, its implementation was postponed till 2013. In September 2012, the reports postponed its implementation for another 3 years. In Budget Speech 2015, the new government indicated that it has been striving to foster a stable and predictable taxation policy and a non-adversarial tax administration as over the past few years. India has been increasingly losing favour with foreign investors as a result of its unpredictable tax regime, to the extent of being termed as the world's most draconian tax regime. Ergo, a series of step has been taken in this regard for the creation of a stable and predictable tax regime in India- deferral of GAAR by 2 years, shelving of Direct Tax Code[40] permanently, and proposed reduction of corporate tax to 25% over the period of next four years, phased removal of all exemptions available to corporate entities etc.

7. BASE EROSION AND PROFIT SHIFTING (BEPS)

Profit shifting is one of the ways in which erosion of national tax bases occur. Multinational companies use 3 mechanisms to shift profits across

[38] http://profit.ndtv.com/news/corporates/article-5-facts-about-the-general-anti-avoidance-rule-gaar-300693(last accessed on 25August 2015).

[39] http://www.ey.com/IN/en/Services/Tax/EY-how-will-doing-business-in-india-change-with-gaar-pranav-sayta(last accessed on 3 September 2015).

[40] Code to replace Indian IT Act thereby consolidating and amending law relating to income/dividend/wealth/fringe- benefit taxes so establish equitable direct tax system to improve tax- GDP ratio(last accessed on 28August 2015).

borders viz*hybrid mismatch arrangement* to take advantage of lower tax rates as same money or transaction is treated differently by different countries, *Special Purpose Entities (SPEs)* with little or no presence in the host economy to avail the benefits of tax agreement of the contracting States, *Transfer Pricing* used to decide how profits should be allocated among the different parts of the company in different countries and how much tax the MNC has to pay and to which tax administration. BEPS concerns fairness and equity in payment of taxes by MNCs for which national level solutions don't suffice.

International tax rules are generally efficient in ensuring that companies are not subject to double taxation, but BEPS takes advantage of gaps in the rules to avoid paying tax completely, so-called "double non taxation" or to pay a sum across two or more countries that is less than what they would pay in a single country.[41]

On this issue of BEPS, OECD published a Report on October 5, 2015 wherein Action Plan 6 elucidates preventing the grant of Treaty benefits in 'Inappropriate Circumstances' i.e. where the main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and treatment. For this purpose, the Report proposes insertion of "Principal Purposes Test" (PPT) to address such cases. The Action Plan will also for example stop the abuse of transfer pricing by ensuring that taxable profits can't be artificially shifted through the transfer of patents, copyright or other intangibles away from countries where the value is created, and it will oblige taxpayers to report their aggressive tax planning arrangements.

The Report also provides clarity on conflict resolution between provisions of Tax treaties and applicability of domestic GAAR through guiding principle of BEPS. BEPS Action Plan also asserts that considering nature and high impact disputes involving implementation of GAAR, an administrative/approval process has to be brought in order to ensure consistency and avoid its unscrupulous application.[42] Thus, under BEPS Action Plan, there is an apparent interaction between Public International Law and Private International Law.

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[41] http://oecdinsights.org/2013/07/19/what-is-beps-how-can-you-stop-it/ (last accessed on 11 September 2015).

[42] http://www.itraf.org/document/OccasionalPaper-5.pdf(last accessed on 23 September 2015).

8. CONCLUSION

The Premise of the Paper lies in elucidating that how International Tax Law though an independent branch of Law is more inclined towards or follows the principles of Private International Law rather than Public International Law. *"International taxation is a body of legal provisions embedded in the tax laws of each country to cover the tax aspects of cross border transactions*. In the Indian context- IT Act, others laws like PMLA, FEMA, GAAR, Black Money Act, judicial decisions (e.g. Vodafone for indirect transfers, Sony for Transfer Pricing (market intangibles) etc.), various upcoming legislations and amendments form the aggregation of those national law/rules which triggered by conflict of tax laws (occurring from each State's sovereignty) due to diversity or duplication of law of each State's internal tax laws. Even though Bilateral DTAAs do exist but the conflict of law situation is resolved by the municipal law itself as In case of conflict between the two, IT Act is applicable (or the more beneficial provision) and also the recent GAAR clearly and unequivocally gives precedence to municipal law over these DTAAs in dealing with cross border transactions tainted with elements like not at ALP, abuse of tax provisions, not in an ordinary employed bonafide manner etc. The 2015 Black Money Act appears to be colour-coding black according to location. The Act does not claim to be noble, equitable or consistent rather fathoms the government's desperation to not lose its tax revenue to any other Country under the garb of insufficiency of statutory provisions dealing with the problem. The Act also provides for entering into agreements by the government with other countries for information exchange regarding resident's money/assets/accounts abroad (like FATCA in US).Thus it can be asserted the International Taxation in fact resembles Private International Law approach rather than Public International law as the solutions to most of the if not all the international conflicts in the matters of taxation lie in the local law (legislations and judicial precedents) itself. Cross Border Tax agreements do exist but they originate from the municipal law itself and in case of any conflict between the two, the latter prevails, though not always.

ANALYSIS OF DOMESTIC TRANSFER PRICING PROVISIONS INTRODUCED BY THE FINANCE ACT, 2012

- Kritika Sharma*

1. INTRODUCTION

Levying taxes is an integral part of revenue collection for any Government and an indispensable means for economic development. Thus, it is only natural for the Government to take all possible steps available to it under the law to levy tax and combat the ever- evolving tactics of tax evasion.

Tax evasion in its simplest form is just not paying your taxes. However in it's more evolved and sophisticated form, it is an intricately connected web of complex transactions that on a casual glance appear completely genuine and unsuspicious and therefore would not ordinarily raise doubt or question.

The estimate is that illicit financial outflows from the developing world totalled a staggering US$ 946.7 billion in 2011, with cumulative illicit financial outflows over the decade between 2002 and 2011 of US$ 5.9 trillion. Some of this was on account of elusive profit allocation through innovative techniques adopted in international transactions.[1]

Such complexities in the international transactions lead to the formulation of 'Transfer Pricing Regulations' in 2001. This brought about transparency in international transactions leading to accrual of taxes.

Of late however, these complex transactions have taken on a domestic hue causing loss of revenue to the State. The impact of this new and

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[1] Dev Kar, Joseph Spanjers, Illicit Financial Flows from Developing Countries: 2003-2012, available at http://www.gfintegrity.org/wp-content/uploads/2014/12/Illicit-Financial-Flows-from-Developing-Countries-2003-2012.pdf last updated in December, 2014.

unique form of financial jugglery at a domestic level is huge on the tax garnering measures by the Government. This step was taken for extending transfer-pricing regulations to domestic transactions through the Finance Act, 2012.

2. TRANSFER PRICING

To understand the concept of transfer pricing in its entirety, one has to go to its genesis, which is cross-border transactions.

Let us take an example of a domestic Indian company that is a subsidiary of an overseas parent company. The rates of taxation in the country of the parent company are lower than India. In this scenario, the subsidiary receives technical expertise and other necessary assistance from the parent company to assist it in the manufacture of a certain kind of product. The domestic subsidiary in turn, exports this manufactured product to the parent company at Rupees 100 per product. Similar products produced by independent comparable companies cost Rupees 150. Therefore, it can be said that the domestic Indian company undersells its product back to the parent company. It discloses far less profit as compared to other similar comparable products. Therefore, what really happens is that the Indian subsidiary company transfers its profits to the overseas parent company because the tax rates in the country of the parent company are lower than those in India.

If such a transaction is permitted at Rupees 100, the revenue earned through taxes in India would be far less when compared to similar products as this mechanism permits transfer of profits to the parent company overseas where the rates of taxation are less. Therefore, while this may not amount to tax evasion per se, it is certainly not the quantum of tax that ought to have been paid had the price of the product been calculated on the basis of comparable cost of similar products.

In order to rationalize this apparent anomaly, a method was introduced where the authorities, while assessing such transactions between the Indian subsidiary company and its parent company abroad, for the purpose of computing the income of the Indian company, take value of the sale price at Rupees 150, which is termed as “arm’s length price”, and thus make subsequent adjustments to the true income of the assese, which is the Indian subsidiary company. Adjustments, which are made to the controlled price by determining and calculating the arm's length, price of a transaction through different methods as listed and elaborately discussed under the Income Tax Rules, 1962.

This exercise of evaluating controlled transactions with similar uncontrolled transactions by finding comparable products and then subsequently making adjustments, if any, through these various methods of fixing arm's length price is known as "Transfer Pricing".

Therefore, in the year 2001 by means of the Finance Act, 2001, Section 92 was substituted by Sections 92 to 92F, thereby bringing into the Indian Income Tax Act, 1961[2] (hereinafter referred to as "1961 Act") provisions that dealt with transfer pricing.

These sections dealt with everything concerning such transactions ranging from definitions, methods of calculating the arm's length price of various international transactions, specifications regarding which transactions constituted international transactions under these provisions, specifications of who can come within the purview of being an associated enterprise, documentation required to be kept by the taxpayers to whom these provisions applied and the penalties they would face for non-compliance thereof.

Thus, in order to fall under the ambit of transfer pricing through these provisions, the following three essentials are required:

(i) There has to be an 'international transaction',

(ii) It has to take place between 'associated enterprises', and

(iii) It has to be calculated at arm's length price.

With the introduction of the aforementioned Sections to the 1961 Act, provision was made to tax international transactions on their real value. This however left a vacuum for similar transactions that are domestic but which, as in the case of international transactions, do not portray the correct taxable value. Therefore, there arose a need to introduce provisions to cater for domestic transactions that are similar to those which are international in nature. Section 92BA was introduced through

[2] Sections 92-97, the Income Tax Act, 1961.

the Finance Act, 2012 to cater for this very situation.

The provisions introduced in 2012 include certain specified domestic transactions under the transfer pricing provisions of the 1961 Act, provided that:

(i) there must be a 'specified domestic transaction',

(ii) it must be between 'related parties', and

(iii) It must therefore be calculated at arm's length price.

The provisions for penalties in lieu of failure of such documentation and compliance have thus effectively been extended to include these specified domestic transactions.

In order to explain domestic transfer pricing, let us take another example of Company A, which is owned by the same person who owns Company B. Company B, unlike company A, enjoys no tax benefits as a result of which the owner shifts his profit from company B to Company A by selling raw material from Company A to Company B at prices substantially higher than those usually accounted for in similar transactions. The authorities shall thus assess this transaction at its arm's length price and accordingly make adjustments to Company B's income. This would qualify as domestic transfer pricing.

3. NEED FOR PROVISIONS FOR DOMESTIC TRANSFER PRICING

The visible need for specific provisions that would stipulate conditions to keep a check on the practices related to domestic transfer pricing was envisaged in CIT v. Glaxo Smithkline Asia Pvt. Ltd.[3], wherein the Supreme Court expressed the need to put into place a mechanism to consider the fair market value of domestic transactions where the tax authorities had reasons to suspect a transfer of profit. Consequently, of the need expressed by the Supreme Court, the Government amended the existing legislation to include domestic transfer pricing.

[3]CIT v. Glaxo Smithkline Asia Pvt. Ltd., 12 SOT 221 (Del).

It is pertinent to note that the reason International transactions were originally brought within the purview of Transfer Pricing Regulations was due to the rise in the trend of transferring profits from an enterprise situated in country with higher tax rates to its Associated enterprise situated in another country with lower tax rates, thus decreasing the net profit paid by the main enterprise. This thereby resulted in decreased revenue in the country where the Assessee company was situated.

Thus, Transfer Pricing Regulations were adopted to combat this developing masked method of evading taxes.

If this were to happen between domestic enterprises, one would not consider it an evasion of taxes since if one company were to transfer its profits to another for had better organize its taxes, the result would ordinarily be revenue neutral though this does not always hold true.

In order to appreciate the reason for this, one has to examine certain fundamental terms that are taken into consideration to assess the true value of transactions.

3.1. Comparable

This term relates to data with respect to the value of a transaction between unrelated parties in an uncontrolled transaction used as a comparison with the value of an international or specified domestic controlled transaction, wherein the two transactions in essence are similar to each other.

3.2. Revenue Neutral

This term is used to describe the situation where the amount of revenue or tax collected by the Government remains the same irrespective of there being various changes vis-a-vis increase for revenue from one source and decrease in another. For example, X the owner of Company A shifts his profits to another Company he owns, Company B, both of which do not enjoy any benefit of deductions via a Tax Holiday. In this scenario, the tax levied, although varied, shall be the same had such a transaction not occurred. This kind of situation, which provides the Government with the same value of tax that it is entitled to receive, had the transaction not occurred, is termed Revenue Neutral in nature.

3.3. Controlled v. Uncontrolled transaction

A controlled transaction is a transaction between associated enterprises; these could be resident or non-resident, for instance, a transaction between Company Y and its subsidiary Company YZ or a transaction between two companies both owned by Mr. A.

An uncontrolled transaction means a transaction between enterprises other than associated enterprises, whether resident or non- resident[4], therefore being determined by the forces of market conditions.

The Apex Court, in *CIT* v. *Glaxo Smithkline Asia Pvt. Ltd.*[5]*,* observed that in the case of a domestic transaction, under-invoicing of sales and over-invoicing of expenses would ordinarily be tax neutral. However, it creates tax arbitrage like situation.

This usually happens in the following two cases:

(i) If one of the related Companies is loss making and the other is profit making and profit is shifted to the loss making concern, and

(ii) If there are different rates for two related units (because of different status, area based incentives, nature of activity, etc.) and if profit is diverted towards the unit on the lower side of tax arbitrage.

For example, it includes sale of goods or services from a non-SEZ area (taxable division) to a SEZ unit (Non-taxable unit) at a price below the market price so that the taxable division will have less profit taxable and non-taxable division will have a higher profit exemption.[6]

3.4. Tax Arbitrage

A tax arbitrage takes place when there are certain Tax Holidays, deductions, or investment programs that offer a tax reduction and elimination to certain businesses. As a result of the presence of these tax holidays and deductions, it becomes possible to transfer profit from 'an

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4Rule IOA [inserted by the Income Tax (Twenty-First Amendment) Rules, 2001 w.e.f. 21-8-2001)].

5CIT v. Glaxo Smithkline Asia Pvt. Ltd., 12 SOT 221 (Del).

6 Durga Rice & Gen Mills v. Assessing Officer Village Ajrawar Ward 3, KaithalIsmailabad, ITA No. 360/Chd/2012.

industry without such benefits' to 'one that has a tax holiday' thereby considerably reducing the taxpayer's burden and at the same time depriving the Authorities from collecting the amount of taxes they are legally entitled to.

This is a situation where taxpayers, through domestic transactions between related domestic partiesutilize the benefits accruing to one of them and accordingly transfer their profits to the lesser tax-paying unit, via expenditure, etc., thus resulting in a different and less amount of revenue to the authorities.

3.5. Tax Holiday

A Tax Holiday is a Government investment plan or program that offers a tax reduction or in various cases, a tax elimination to businesses. Generally, we use it as a method to reduce sales tax by local governments.

The Governments of developing countries, in order to stimulate foreign investment, also use the concept and mechanism of Tax Holidays. Developing countries adopt this method to increase their GDP (Gross Domestic Product).

4. POSITION PRIOR TO THE FINANCE ACT, 2012

Before amendment to the Finance Act, 2012, cases of domestic transfer pricing were dealt with under Section 40A(2)[7] of the 1961 Act, which provided that unreasonable or excess payment made to a related party or group companies be disallowed. Such a method was upheld in judgments delivered catena of cases like *KR Motilal*v. *CIT*[8], *Mangal Chand Tubes Pvt. Ltd.* v. *CIT*[9]**.**

The problem that arises here is that the provision enabled the Assessing Officer to disallow that expenditure, or part thereof, that was unreasonable or in excess without defining the terms.

It is pertinent to note that the provisions do not per se dictate 'what'

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[7] Sec. 40, Income Tax Act, 1961.
[8] KR Motilal v. CIT, (1999) 240 ITR 810 (Mad).
[9]Mangal Chand Tubes Pvt. Ltd. v. CIT, (1994) 208 ITR 729 (Raj).

constitute reasonable expenditure. This, as in the case of any term left ambiguous under the provisions of law, leads to great tribulations and allows various degrees of arbitrariness that is exercised on the victims of interpretation of such ambiguous provisions. In this case, the recipient of this arbitrary exercise is the assesse, and this effectively causes an obstruction of justice. Apart from opening the door for various Revenue authorities to use their discretion without bounded parameters or limit, whether in or against the interest of various principles of equity, natural justice and fair play, it also gives the assessee ample opportunity to question the use of such discretion at each stage thus leading to unaccountable amounts of litigation crowding an already overburdened judicial mechanism.

Thus, well-defined provisions were required to give better credibility to the disallowances and adjustments made under the provisions relating to Domestic Transfer Pricing. Therefore, the need clearly arose for putting a proper mechanism in place for determining the reasonable or fair value of certain kinds of expenditure. This subsequently led to the amendments brought in by the Finance Act, 2012 that extends the application of Arm's Length Price to certain specified transactions.

Apart from unreasonable expenditure made to related parties as under Section 40A(2), the concept of Domestic Transfer Pricing, prior to the Finance Act, 2012, was also covered under Sections 801A[10] and 801B, which dealt with the transfer of goods and services under various circumstances.

5. TRANSFER PRICING PROVISIONS EXTENDED TO SPECIFIED DOMESTIC PROVISIONS THROUGH THE FINANCE ACT, 2012[11]

The Finance Act, 2012 brought various changes relating to the type of transactions that would fall under the gambit of Transfer Pricing provisions, the documentation statutorily required to be maintained by the perpetrators of such transactions and the relation between the parties transacting in order for these provisions to apply.

Soon after the *Glaxo Smithkline* case, the provisions of transfer pricing

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[10] M/s Tweezerman India Pvt Ltd v. Addl. CIT, 2010-TII-4S-ITAT-MAD-TP.
[11] CIT v. Discovery Estates Pvt. Ltd., ITA 1089/2011.

were extended to certain specified domestic transactions between related parties in terms of Section 92BA, which is the main provision that defines the concept of "Specified Domestic Transactions".

5.1. Amendments made by the Finance Act 2012 in relation to Domestic transfer pricing

Apart from the insertion of Section 92BA[12], the other amendments made in relation to Domestic Transfer Pricing include[13]:

(i) The proviso to section 40A(2)(a) which adds payment to relative or close associates to the list of specified domestic transactions to be taken at Arm's Length Price,

(ii) Extension of the meaning of related parties in Section 40A(2)(b) to include any other company carrying out business or profession in which the first mentioned company has substantial interest,

(iii) Explanation to Section 44AB stating that the due date for furnishing a report in the case of an international transaction or specified domestic transaction being undertaken is to be 30th November,

(iv) Amendment to Section 80A(6) extending the applicability of Section 92BA to the deductions under 10AA or 80lA to 80RRB,

(v) Provisions of Section 80IA(8) and 80lA(10) now stating that the transactions under these sections are to be treated as Specified Domestic Transactions and are to be taken at arm's length price, and (vi) Section 90(2) and 90A(2) which extend the applicability of the provisions of Chapter X-A of this Act even in situations where they are not beneficial to the Assessee.

5.2. Jurisdiction

Unlike transfer pricing provisions related only to international transactions, the amended provisions extend to specified domestic transactions. Therefore, if proceedings were held under the premises that a 'specified domestic transaction' is being undertaken, then the

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[12]CIT v. Discovery Estates Pvt. Ltd ITA 1089/2011.

[13]Chapter X-A, the Income Tax Act, 1961.

subsequent jurisdiction would pertain to transactions within the domestic territory only. In addition, the aggregate of these transactions being assessed has to exceed Rupees Five crores; only then will it evoke the jurisdiction of these provisions. However, there are some circumstances under which domestic transfer pricing provisions are not restricted to resident entities, for example, in the case of a Company paying remuneration to its non-resident director, the transaction although cross-border would still be considered as a domestic transaction.

6. CONCEPT OF DOMESTIC TRANSFER PRICING

The concept of domestic transfer pricing works on the same principle of transfer pricing in general but instead involves specified domestic transactions, as defined under Sections 40A(2)(b), 80IA(8), 80IA(10) and 10AA, between related parties defined under Section 40A (2)(a)(i).

Section 92BA[14]states that the transfer pricing provisions shall apply to certain domestic transactions and then goes on to define these transactions.

To understand intricately as to what transactions this provision extends to, that is, what transactions come within the purview of being a 'specified domestic transaction', each of the six categories of eligible transactions are dealt with separately.

The first being expenditures that have been or are supposed to be paid to the related parties as listed as under Section 40A(2)(b). This would refer to expenditures such as that on buying goods, on procurement of services, expenditure on interest payments, expenditure on salary, training services, marketing expenses, expenditure on purchase of tangible and intangible property, etc.

The second category deals with Section 80A under Chapter VI-A. This chapter deals with various deductions that the assessee is allowed to make while computation of his gross income for the purpose of assessment. We are concerned, however, with specified domestic

[14]Meaning of Specified Domestic Transactions, Sec. 92BA, Income Tax Act, 1961 (wef. 01/03/2013).

transactions, more specifically with Section 80A(6) which states the when goods and services are transferred between related parties; the consideration for said transaction has to be taken at arm's length price.

The third category of transactions deals extends the applicability of specified domestic transactions to transfer of goods and services as under Section 80IA(8) if it is observed by the Assessing Officer that they are not fair market value or at arm's length price. These would include inter unit transfers and extraordinary profits earned by units availing Tax Holidays or other tax deductions and exemptions.

The fourth category of transactions refers to Section 80lA(10) when it appears to the Assessing Officer that the assessee is accruing extraordinary profits in relation to its transactions with business, etc., and these profits accrue either due to close relations of the assessee with the other party or otherwise, then while considering the same for deductions as under the provisions of Chapter-VI, the value of these profits shall be taken at arm's length price as defined under Section 92F.

The fifth limb of Section 92BA further extends the meaning of specified domestic transactions to cover transactions under any other provisions of Chapter-VI-A or Section IO-AA, thereby including Section 80IAB, 80lB, 80lC, 80lD, 80lE, etc.

Lastly, the section also keeps the door open for various CBDT orders to add other categories of transactions to the existing list.

Not only does this provision define a specified domestic transaction but it also declares a threshold limit for these transactions. It is only after crossing this limit would such transactions come under the purview of a specified domestic transaction as per this Act and accordingly take at arm's length price. Thus, according to these provisions specified domestic transactions would, effectively yet not exhaustively, include transactions like payment for purchase of semi- furnished goods, transfer of machinery, technology, transfer of interest, royalty, transfer of goods and services in certain cases, rent, payment made to personnel and in various cases to relatives.

6.1. Related Parties

Now the question that arises is between whom such a specified domestic transfer would have to take place in order for it to invoke the domestic transfer pricing regulations under this Act. To answer this question, Section 40A of the Act[15] must be read.

The term 'related parties' has effectively been defined under Section 40A (2) (b). This can be systematically analysed to cover both individuals and juristic persons and, under certain circumstances, a combination of the two. As far as individuals are concerned, the Act[16]provides that the ambit of related parties is to cover their various relatives. It also states specifically that when the assessee is a juristic person, that is, a company, an association of persons, a firm or a Hindu undivided family, the term related parties would take within its definition any director of the company, partner of the firm or any member of the association or Hindu undivided family and any relative of such director, partner or member. It further includes persons both natural as in the case of individuals and juristic, who have a substantial interest in the business and profession of the assessee and various persons related to such persons.

It is important to note that for a person, both natural and juristic, to be shown to have a substantial interest in the business or profession of the company, etc., such person must be beneficially entitled to not less than twenty percent of the shares of said company, etc.

6.2. Computation of Arm's Length Price

Section 92F(ii) defines "arm's length price" as a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled transactions.

The computation of arm's length price is in essence a factual exercise committed to establishing that the conditions that are imposed in financial or commercial transactions between associated enterprises are astute to and in harmony with the arm's length principle. Financial or commercial uncontrolled transactions between unrelated or independent enterprises, the market forces impose various conditions and the market forces and conditions dictate these transactions. However, it is not so in controlled transactions and while a company in dealing with its related branch or other such related party might try and duplicate market conditions, the assumption is that these companies through their various

[15] Section 40A, the Income Tax Act, 1961.
[16]Section 40A(2)(b), ibid.

related parties manipulate and distribute their respective incomes in order to achieve a more favourable tax assessment. This assumption can effectively be refuted by computation of arm's length price and showing how the transaction has taken place at the same value as any uncontrolled transaction of a similar kind. Thus, the company must choose the most appropriate method of computing the arm's length price of the international or specified domestic transaction undertaken by it. Which of the five, now effectively six, methods is most appropriate for that particular transaction depends essentially on the facts and circumstances specific to the company and transaction.

Section 92C[17] clearly prescribes five distinct methods of determining the arm's length price of a transaction and states a sixth method being any other method as prescribed by the board. The ambiguous 'other method' contained in this provision has been given a more concrete form via the insertion of Rule 10AB to the Income Tax Rules, 1962.

Further, Rule 10B in considerable detail lists these methods. Recently in the *LG* case[18], a new method named the bright line test method was used even though it is not listed as a method as under the Income Tax Act, 1961 and Income Tax Rules, 1962[19]. This has been a highly debated topic, discussed in several cases including *Ford India P. Ltd.* v. *DC IT*[20] and *CIT* v. *Glaxo Smithkline Asia Pvt. Ltd.*[21].

6.3. Applicability of new domestic transfer pricing provisions (w.e.f 2012-13)

In order to fit the criteria for subsequent compliance and proceeding, three basic elements are required before an assessee can be brought under the newly inserted domestic transfer pricing provisions.

Firstly, the assesse must have undertaken a specified domestic transaction as defined under the Act.

Secondly, the said transaction must be between related parties as also defined and stated under the provisions of the Finance Act 2012.

17Section 92C, Computation of Arm's Length Price, Income Tax Act, 1961.
18L.G. Electronics India (P.) Ltd. v. AClT, [2013] 29 taxmann.com 300 (Delhi-Trib.).
19Pereftti Van Melle India Pvt. Ltd. v. Assessee, ITA NO.58971DELl2012.
20Ford India P. Ltd. v. DC IT, (2013) 25 ITR 456 (Chennai-Trib.).
21 CIT v. Glaxo Smithkline Asia Pvt. Ltd., 12 SOT 221 (Del).

Lastly, the aggregate of the transactions undertaken by the assessee in the financial year[22]that qualify as specified domestic transactions should be more than five crores.

Thus only after all these three conditions are fulfilled can the authorities regard the assessee as subject to the provisions for specified domestic transactions, which in turn subject it to all the transfer pricing provisions that first only applied to international transactions.

7. IMPLICATIONS OF THE FINANCE ACT, 2012 WITH RESPECT TO DOMESTIC TRANSFER PRICING PROVISIONS

7.1. General Implications

The implications of these amendments are cohesive with the purpose of their employment, that is:

(i) To empower Revenue to adjust the income as portrayed by the assessee giving value to the arm's length price of the transaction, and

(ii) To make detailed documentation of various transactions undertaken by the employee mandatory and subject to statutory compliance under these provisions.

7.2. Less ambiguity

It thus renders the provisions aimed at curbing the craft of domestic transfer pricing relatively unambiguous and sets down a comparatively standardized method of evaluation and assessment for combating these situations. In addition, the type of transactions that fall under scrutiny are clearly defined and listed. The specific relationship required to render to parties eligible for qualifying as related parties is detailed. The question of reasonableness, which is the root from which this amendment originated is also resolved by the mechanism of calculating the arm's length price through the various methods listed in Section 10B of the Income Tax Rules 1962. This decreases the scope of arbitrariness in the exercise of

[22]Income of the previous year is chargeable to tax and thus for the purpose of the Income Tax Act, previous year is the Financial year [F. No. 205/4/90-IT.A-II, dt. 22-05-1990 from CBDT].

discretion by the concerned authorities.

7.3. Shift from Fair Market Value to Arm's Length Price

Post Finance Act, 2012, we witness a generic change and effective shift for fair market value to arm's length price. While fair market value is calculated with basic market values and reports, arm's length price can be calculated through specific methods like cost plus method, etc. Fair market value can be taken at any pricing point of a market while Arm's Length Price is the arithmetic mean of comparable prices. While for fair market value even the one particular value is enough for comparison, the calculation of arm's length price requires a much larger sample size of comparables.

7.4. Domestic Transactions to be at Arm's Length Price

The Companies, enterprises, Hindu Undivided Families, or various other persons being the assessee, if purported to be undertaking's 'specified domestic transactions' have to show vis-à-vis detailed documentation and records that these transactions and the various considerations and the like are valued at arm's length price.

7.5. Documentation

Due to changes that are laid down in this Act that made, transfer pricing provisions applicable to these specific domestic transactions, Assessees with no international transactions or link whatsoever also have to comply with the stringent requirements for the maintenance of detailed documents relating to these transactions.

7.6. Double Taxation Conundrum

It is to be noted that while there are provisions under this Act to make adjustments or disallow expenses at the hands of a taxpayer, corresponding adjustment is not allowed to the recipient of such income. This thus leads to circumstances where the fatiguing concept of double taxation surfaces yet again. Thus, relative adjustments are not made under these provisions. For example, if rent paid by A to a related party B worth Rupees 50 Crores is considered excessive under Section 40(A) (2) and is added to the income of A, a subsequent decrease in the income of B will not be made. In other words, the provisions only take into consideration of expenditure and not income.

7.7. Transfer Pricing Adjustment

In case it is observed that the transaction is not at arm's length price, then accordingly an adjustment shall be made with respect to the difference in the value of the transaction and the arm's length price. This adjustment in the form of a disallowance shall naturally result in enhancement of income and subsequent levy of tax or interest.

7.8. Impact on the Assessee

These provisions may have adverse implications on the taxpayer and will thus effectively make it extremely difficult for the taxpayer to organize his affairs in a manner that will benefit him in terms of taxes paid. It also includes individuals within the ambit of transfer pricing and thus adds the burden of excessive documentation and compliance on various individual taxpayers as well as the others that fall under these provisions.

7.9. Impact on E-Businesses

Under the existing regulations for foreign direct investment in India, companies with foreign investment are not permitted to carry B2C (Business to customers, for example eBay) e- commerce. Thus, in order to achieve this, such companies with foreign investment have created various models (the distinct company model, marketplace model and the private model), usually involving more than one company, both of which are invariably related to each other. These shall now come under scrutiny, given the new domestic transfer provisions, thus adversely affecting such companies.

7.10. Reference to the Transfer Pricing Officer

Section 92CA stipulates that where the assesse undertakes an international transaction or a specified domestic transaction, the assessing officer may, with the prior approval of the Commissioner, refer the computation of arm's length price under Section 92C to the Transfer Pricing Officer in relation to the said international or specified domestic transaction, if he finds it expedient and necessary to do so. Section 92CA(2) further stipulates that the Transfer Pricing Officer, after receiving a reference via the assessing officer regarding the international or specified domestic transactions undertaken by the assesse, must serve a notice to the assessee requiring him to produce, on a date specified therein, any such evidence that have may have relied on in support of his computation of the arm's length price of the international or specified domestic transactions that have accordingly been referred to the Transfer Pricing Officer.

7.11. Powers of the Transfer Pricing Officer

Earlier, it was understood that the reference to the Transfer Pricing Officer is transaction and enterprise specific. However, in view of the insertion of sub-section (2A) and (2B) a fresh question arose as to whether the Transfer Pricing Officer, to whom a reference has been made, concerning certain international or specified domestic transactions, can in fact, consider other such international or specified domestic transactions that have not been expressly referred to him.

The answer to this question, as given the provisions of sub-clauses (2A) and (2B) of Section 92CA, is in the affirmative. The Transfer Pricing Officer can now take into consideration international or specified domestic transactions not expressly referred to him. This view was upheld in *Vodafone India Service Pvt. Ltd.* v. *Union of India*[23] and *Reebok India Co.* v. *ACIT*[24].

7.12. Section 92CA (7)

Also, as per section 92CA(7), the Transfer Pricing Officer while calculating the arm's length price may exercise the powers of an assessing officer under Section 131(1) and Section 133(6). These are powers for summoning or calling for details tor the purpose to investigation and enquiry into the matter.

7.13. Westminster Principle Effectively Inapplicable

The Westminster[25] principle, which is the cardinal principle in English law, states, "given that a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance." It was speculated that the Ramsay Principle as held in *McDowell and Co. Ltd. case* overruled this principle. However, it was applied in *UOI* v. *AzadiBachaoAndolan*[26] after observing that it was

[23]Vodafone India Service Pvt. Ltd. v. Union of India, [2013] 37 taxmann 250 (Bom.).
[24]Reebok India Co. v. ACIT, [2013] 32 taxman 869 (Mumbai-Trib.).
[25] IRC v. Duke of Westminster 1935 ALL ER Rep 259.
[26] UOI v. AzadiBachaoAndolan, (2004) 10 SCC 1.

still being applied in England[27].

This principle allows a man to organize his taxes in a manner that will be most profitable to him within the specified provisions of law. However, all such transactions can now be challenged under the Finance Act, 2012 which effectively makes it close to impossible for a person, both natural and juristic, to structure their incomes, profits and losses.

7.14. CBDT Notification (Notification No.41-10/06/2013)

This CBDT Circular aims to facilitate the proper implementation of the amendments brought into the Indian transfer pricing provisions through the Finance Act, 2012. It extends the application of Rules 10A, 10AB, 10B, 10C, 10D and 10E to Specified Domestic transfer thus, amending these rules and replacing the words "international transaction" with "international transaction or specified domestic transaction". Italso amends Rule 1UAto include a definition of "Associated Enterprises" that applies specifically to Specified Domestic Transactions. The CBDT also amended Form 3CEB to accommodate Specified Domestic Transactions by adding Part-C that requires information regarding the Specified Domestic Transactions entered into by the assesse just as Part- B is to contain detailed information regarding International Transactions. The annexure attached to Form 3CEB was also amended to include various Specified Domestic Transactions.

7.15. Compliances under New Provisions

Under the new provisions, taxpayers are now required to identify any Specified Domestic Transactions that they might have entered into. If any such transactions have been undertaken and identified and the aggregate value of these transactions exceeds five crores, then the taxpayer is required to analyse these transactions and subsequently report and obtain a certificate with respect to these transactions in the format of Form 3CEB.

[27]Craven v. White, 1988 3 ALL ER 495; Mcnaiven v. Westmoreland Investments Ltd., 2001 1 ALL ER 865 (HL).

7.16. Provisions of Law

Under the new provisions specified, domestic transactions are also required to be recorded and documented under the same rules and provisions related to transfer pricing as international transactions. Thus the taxpayer is required to maintain information and documentation with respect to specified domestic transactions as mentioned in Sec 92D and further stipulated by Rule 10D and is according to Rule 10E required to furnish a report in the form of Form 3CEB as under section 92E.

7.17. Form 3CEB

This certificate is to be furnished and subsequently approved by a chartered accountant in its proper format, which consists of three parts and an annexure of transactions. The CBDT notification 41/2013 amended Form 3CEB and inserted a third section to it as under 'Part-*C',* so as to include specified domestic transactions, and to facilitate the regulation of domestic transfer pricing as envisioned in the Finance Act 2012. Thus, part A of Form 3CEB contains information and particulars of the assesse; Part-B consists of details of International Transactions undertaken, if any; Part-C consists of details related to Specified domestic transactions. As of now, five categories of information regarding specified domestic transactions are to be mentioned in Form 3CEB, which are as follows:

i. List of Associated Enterprises with respect to the specified domestic transactions and their details and particulars;

ii. Particulars of transactions as under section 40A;

iii. Particulars of transactions are under section 80 IA (8), Section 80A or Section 10-AA;

iv. Particulars relating to transactions with businesses resulting in more than ordinary profits as under section 80 IA (6);

v. Particular with respect to any other transactions.

In addition, the new Form 3CEB requires more details and particulars and is more thorough in nature, thus expressing the newly acquired enthusiasm of the tax authorities. Thus this, coupled with other provisions related to default of furnishing such a report and other mandatory documentation, puts an onerous responsibility on the taxpayer and chartered accountant to handle the issue of reporting very meticulously and efficiently.

7.18. Required categories of Information & Documentation:

The documentation required to be furnished by the assesse can be broadly divided into three categories; entity related, price related and transaction related.

Entity related documentation includes the profiles of the industry, the group, the enterprise, and its associated enterprises. Price related documentation would include terms of transactions, FAR analysis (Functions, assets, and risks), method selection, comparable benchmarking, budget, and forecasts. Documentation related to transactions including pricing policies, agreements, pricing related correspondence (letters, emails, etc.), business plan, management's accounts, reports, etc. For example, if the transaction is the interest paid on a loan, then details of how the interest rate was determined, details of the loan agreement and the basis on which the rate of interest is higher than the standard value of interest and other such details shall be filed.

7.19. Penalties for Non- Compliance of Provisions for Domestic Transfer Pricing

The penalties for non-compliance are severe under Transfer pricing regulations. The provisions of the 1961 Act regarding penalties to be imposed that adhere strictly to transfer pricing are stated as u/sec. 271AA[28], 271BA[29]& 271G[30]

Other general provisions for imposing penalties are provided under Section 271(1)(C) which states that where the Assessing Officer or Commissioner (Appeals) during the proceedings under these provisions is satisfied that a person has conceal the particulars of his

[28]Section 271AA, Penalty for failure to keep and maintain information and documents in respect of International transactions or specified domestic transactions, Income Tax Act, 1961.

[29]Section 271 BA: Penalty for failure to furnish report under section 92E, ibid.

[30]Section 271 G: Penalty for failure to furnish information or document under section 92D, ibid.

income or furnished incorrect particulars of such income then according to (iii) of Section 271(1)(c), he can direct him to pay by way of penalty, in addition to the tax payable by him, if any, a sum which shall not be less than the amount and not more than three times the amount of tax sought to be evaded by him by reason of concealment of the particulars of his income or failure to furnish particulars of such income. This provision thus imposes a 100-300% penalty on the taxpayer.

8. OECD GUIDELINES AND TRANSFER PRICING PROVISIONS

The challenges faced by the OECD and developing countries while trying to develop transfer-pricing provisions, is the same, that is, the conflict between trying to protect their tax base versus not creating situations of double taxation or the uncertainties that could hamper foreign direct investment and cross border trade.

According to the OECD's Multi-Country Analysis of Existing Transfer Pricing Simplification Report, the 18 countries [31] answered in affirmative to the question of whether in their country transactions among domestic related parties are also subject to arm's length price:

The following 11 countries [32] answered in negative that domestic transactions between related parties are not subject to the arm's length principle in their country:

The country of Switzerland has defined specific rules for interactional profit allocation between associated enterprises. However, these rules do not necessarily comply with the arm's length principle.

In Slovenia, transactions amongst domestic related parties are also subject to the arm's length principle, but the arm's length principle among these domestic related parties is only used in the following circumstances or situations:

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[31] Austria, Czech Republic, Denmark, Estonia, Finland, France, Hungary, Ireland, Israel, Luxemburg, Mexico, Netherlands, Norway, Poland, Spain, Turkey, United Kingdom, United States.

[32] Argentina, Australia, Belgium, Canada, Chile, Italy, Japan, Korea, New Zealand, South Africa, Sweden.

i. If one of the domestic related parties in the tax period for which revenue and expenses are established, discloses an uncovered tax loss carried forward from previous tax periods; or

ii. If one of the domestic related parties pays tax at a zero per cent rate or at a special rate, lower than the general tax rate in CITA-2; or

iii. If one of the domestic related parties is exempt from paying tax under CITA-2.

Thus, here the arm's length principle among domestic parties is more an anti avoidance issue rather than being a transfer pricing issue.

In Germany, transactions between domestic related parties are subject to the arm's length principle only in specific cases where the domestic transaction leads to a hidden profit distribution.

9. INTERPLAY BETWEEN THE FINANCE ACT, 2012 AND THE COMPANIES ACT, 2013

There is a degree of interplay among the provisions related to domestic transfer pricing in the Finance Act, 2012 and Section 188 of the Companies Act, 2013 that deals with Related Party transactions. It stipulates that any transaction proposed to be undertaken with respect to a related party shall first be put before the Board for approval and only then shall it be entered into. In addition, it mentions certain figures relating to the threshold for such transactions and states that if the proposed transaction is beyond a certain amount as prescribed in the Act, then the question of whether it should be undertaken or not shall also be placed before the shareholders of the Company.

10. CONCLUSION

In conclusion, the Finance Act, 2012 has opened the door to a much higher level of stringency where transfer pricing is concerned. It has altered the way transfer-pricing regulations were looked at in India, and by bringing domestic transactions under the purview of such regulations, this Act has effectively pushed the tax evaders into a tight corner. However, it can be said that it is purely beneficial and has no adverse ramifications. The Act imposes an immensely arduous system of documentation and onerous reporting on taxpayers, though not all of whom may even be involved in conspicuous profit allocation activities, and levies heavy penalties in lieu of failure to maintain such documentation and reports. In addition, other challenges faced include the identification of accurate comparables as under this scheme of domestic transfer pricing. To conclude, through its wide ambit that brings individuals as well within the contours of transfer pricing regulations, this Act has widened the scope of the existing provisions and has put in place a rigorous scheme of documentation and penalties.

[CASE COMMENT]

CHD DEVELOPERS LIMITED, KARNAL V. STATE OF HARYANA AND OTHERS – FOLLOWING THE *LARSEN*FOOTPRINT?

- **AnandVardhan Narayan***

ABSTRACT

The Punjab and Haryana High Court in its watershed pronouncement, recently, held that the value of land related to a building contract has to be deducted from the tax levied as per the Haryana Value Added Tax Act, 2003. The Court, whilst delivering a novel judgment on building contracts, debated on the issues of the legislative history pertaining to the taxability of 'works contracts', the pre-conditions and subject for levy of VAT on such form of a contract – outlining the method of determining taxable turnover in such cases and adjudicating the constitutional validity of certain provisions in this regard; thereby also reiterating the Larsen case's verdict that building contracts are a species of works contract. The decision has attained great significance since it not only points out the lacunae in the existing legislation, but also serves as a relief to the builders who were rendered helpless by the ambiguous law. Furthering the deliberation, the authors have attempted a critical and multi-dimensional analysis of the impact that this judgment will have on all the concerned stakeholders – the builders, the customers and the Government. This commentary proceeds by laying out the factual premise of the case, identifying the key issues therein and stating the judgment passed by the Court. It then undertakes a critical analysis of the verdict, expostulating the hits and misses of the Court in the process. To conclude with, the authors have pointed out the profound impact this decision will have on the building sector in the backdrop of the burgeoning real estate market.

1. INTRODUCTION

On April 22, 2015, the two-judge bench of the Punjab and Haryana High Court, in a landmark decision, held that the immovable property's value that is involved in the execution of a building contract needs to be subtracted when tax is levied under the Haryana Value Added Tax Act,

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2003 (hereinafter referred to as **'Act'**) pertaining to building contracts[1] - that has been held to be a works contract by the Apex Courts verdict in the matter of *Larsen and Toubro Ltd. v. State of Karnataka*[2] ('**Larsen case**').

2. LEGAL HISTORY AND EVOLUTION OF WORKS CONTRACT

Taxability of works contract has been a subject matter of excessive litigation in India for several decades. Before delving further, it is important to understand the concept of 'works contract' and the confusion associated with taxability of the same. Works contract is a composite contract which is a contract for work, service or labour and not for sale of goods; however, goods are used in executing such contracts. For example, generally in a construction contract, buyers enter only into a contract to buy flats/buildings, and the contractor *inter-alia* has to purchase the material and use them for constructing the building. When the buyer makes payment for the cost of building upon its completion, such payment also includes cost of building material, labour and other services offered by the contractor. Broadly speaking, the property in building is passed on to the buyer and there is no separate contract for supply/sale of building materials in a works contract.

The bone of contention was regarding the taxability on such supply/sale of building materials. Entry 54 of the State List (List II) in the Constitution of India empowers the State to levy tax on the sale or purchase of goods. The moot question was whether by virtue of this Entry, the State is authorized to levy and collect tax on the materials supplied/transferred in execution of works contract. The State government was levying sales tax on such material supplied for execution of works contract by arguing that they can bifurcate the works contract and tax on the supply/sale portions of it. Finally, the Supreme Court intervened in the case of *State of Madras v Gannon Dunkerly& Co.*[3], and held that a building contract is indivisible work contract and it is not permissible for the State governments to levy sales tax on the transfer of property in the goods involved in execution of such contract. As an implication of this case, States were not able to levy and collect any tax

[1]CHD Developers Limited, Karnal v. State of Haryana and others, Civil Writ Petition No. 5730 of 2014 (Punjab and Haryana High Court, 22/04/2015).

[2]Larsen and Toubro Ltd. v. State of Karnataka, (2013) 46 PHT 269 (SC); (2014) 1 SCC 708.

[3]State of Madras v Gannon Dunkerly& Co, AIR 1958 SC 560.

on goods involved in the execution of works contract. The Tax payers were avoiding sales tax under the guise of 'works contract'. This peculiar problem was referred to the Law Commission of India. Accordingly, the Commission in its sixty-first report[4]recommended that the law must be amended to confer power on the State Government to tax the 'goods' involved in the execution of works contracts. By way of 46th Constitutional Amendment, 1983, Clause 29A was inserted to Article 366 (Article 366 defines 'tax on the sale or purchase of goods') to include within its ambit transfer of property in goods involved in the execution of works contracts. This constitutional amendment permitted the States to levy tax on the sale of goods involved in execution of works contract. The validity of such provision was affirmed by five judge bench of Supreme Court in *Builders Association of India v. Union of India*[5], wherein it was held that after the constitutional amendment it was permissible for the State government to levy sales tax upon the goods portion involved in the execution of a works contract. After several judicial pronouncements and legislative amendments, the law was finally settled and States were levying and collecting sales tax on the material used in execution of a works contract. However, what constituted works contract and the manner of taxing such contract continued to be litigated.

3. BACKGROUND OF THE CASE

The Hon'ble Supreme Court in the *Larsen case*[6] has enlarged the definition of 'works contract' to include within its ambit the activities of the builders, contractors, etc. in construction of flats, buildings and commercial properties. Accordingly, the state was empowered to levy VAT on the said activities which fall under the definition of 'works contract'. This authoritative decision left no room for doubt in the minds of the taxing authorities and also the builders as regard to the levy of VAT on the activities of the builders. However, most of the builders in the State of Haryana and Punjab did not start paying VAT voluntarily due to certain grievances. Accordingly, the Hon'ble Punjab and Haryana High Court witnessed plethora of writ petitions filed by these builders

[4] 61st Law Commission of India Report, *Certain Powers Connected with the Powers of the State to levy a Tax on the Sale of Goods and with the Cenral Sales Tax Act, 1956*, 21 (1974), available at http://lawcommissionofindia.nic.in/51-100/report61.pdf (last accessed on 12 October 2015).

[5] Builders Association of India v. Union of India, (1989) 2 SCC 645.

[6] *supra*, at p. 2.

against the assessment orders[7] issued to them as regard to the levy of VAT on their activities of constructing flats and buildings. Among the writ petitions, the present case was the lead one. The major grievances of the builders were that the value of land involved in execution of works contract was subjected to the levy of VAT under the guise of 'works contract'. The builders challenged the assessment notices, circulars and prayed for issuance of writ declaring Explanation (i) to Section 2(1)(zg) of the Act and Rule 25(2) of the Haryana Value Added Tax Rules (hereinafter referred to as **'Rules'**) *ultra vires* to the Constitution of India to the extent that they include the value of land while charging VAT.

4. FACTS OF THE CASE

The petitioner, who was a developer, was engaged in the business of development and sale of apartments/flats/units. The petitioner entered into a flat buyers' agreement with prospective and interested buyers. The sale deed was executed on payment of stamp duty on total consideration to sell the property. The Excise and Taxation Commissioner issued a Circular dated May 7, 2013 stating therein that VAT will be charged for all those builders, who are entering into agreements for sale of constructed apartments prior to or during construction. On June 4, 2013, the Excise and Taxation Commissioner issued a circular about the making of assessments on developers and builders. Consequently, the Circular dated May 7, 2013 was varied *vide* Circular dated February 10, 2014 and value of land was sought to be included for imposition of VAT.

[7] B. L. Gupta, *Liability of the Builders/Developers under the VAT Laws - Impact of Punjab & Haryana High Court order in CHD Developers, Karnal Case*, GST Simplified, available at http://www.gstsimplified.in/news-publications/liability-of-the-builders-developers-under-vat-laws-impact-of-punjab-haryana-high-court-order-in-chd-developers-case (last accessed on 27 September 2015).

5. CONTENTION OF THE PARTIES

5.1. Key Arguments placed by the Petitioner

The petitioner contended that the imposition of tax as demanded by the taxation authorities was unconstitutional and beyond the provisions of the Act and under the Rules framed therein. The counsel for the petitioners contended that since builders were engaged in sale of immovable property, their activities should not be construed as 'works contracts' as contained in Section 2(1)(zt)[8] of the Act. Most importantly, they argued that Explanation (i) to Section 2(1)(zg)[9] of the Act and Rule 25(2)[10] of the Rules were ultra viresto the Constitution of India. To substantiate this argument, they contended that Entry 54 of the State List empowers the State to charge tax on transfer of property in goods in execution of works contract[11]; however, contrary to the powers provided by the Entry, the State is trying to charge tax on a value which was far in excess of the value of goods transferred in the course of execution of works contract. Key Argument placed by the Respondent

The Respondent by relying on the judicial pronouncement by the Hon'ble Supreme Court in the *Larsen case*[12] contended that the activities of constructing of buildings, flats and commercial properties by the developers and builders were liable to sales tax laws of the State. The reason being that such activities are covered in the definition of 'works contract' as provided in Section 2(1)(zt) of the Act.[13]Most importantly, they contended that there is a transfer of property in the execution of the contract and such transfer of property in goods was covered under Section 2(1)(zt) of the Act.[14] Based on all the above submissions, it was argued that the petitioner was contractor and the prospective buyer a contractee.

6. KEY ISSUES BEFORE THE COURT

The key points for adjudication before the Court were as follows:-

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[8]The *Haryana Value Added Tax Act*, 2003, s. 2(1) (zt).
[9]*id.*, at s. 2(1) (zg).
[10] The *Haryana Value Added Tax Rules*, 2003, Rule 25(2).
[11]Entry 54, List II, the Constitution of India.
[12]*supra* 2.
[13]*supra* 8, at s. 2(1) (zt).
[14]*ibid.*

a) Whether the developers and builders can be treated as works contractor?
b) Whether the State can impose VAT on the developers/builders, who *vide* an agreement with the prospective buyer has agreed to construct a flat and thereafter sell the same with some portion of land?
c) If the answers to the above issues are in affirmation, whether the method of valuation of VAT on such agreements, can directly or indirectly, include the value of land by following the method of calculation of the taxable turnover as provided by Commissioner *vide* Circulars dated May 7, 2013,June 4, 2013 and February 10, 2014?
d) Whether Section 42 of the Act[15] is legally valid or not?

7. JUDGMENT

The writ petition was partly allowed by the Court. Based on the below mentioned reasoning, the Court struck down the assessment order and revisional order passed by the concerned authorities and ordered for fresh assessment. For clarity, the authors have sub-divided the issues and reasoning given by the Court.

7.1. Legislative History of the Taxability of 'works contract': Implication of the Forty Sixth Constitutional Amendment

The Court, while adjudicating the first two issues, delved into the legislative history of the taxability of 'works contract', various definitions and other provisions under the Act. The Court noted that prior to the Forty Sixth Constitutional Amendment (hereinafter referred to as '**Amendment**'); composite work contracts were not exigible to States sales tax under Entry 54 of the State List,[16] which pertains to '*tax on the sale or purchase of goods.'* The Court discussed the implications of the Amendment which inserted a new clause (29A) to Article 366 to expand the meaning of the expression '*taxes on sale and purchase of goods*'.[17]Sub-clause (b) of clause (29A) states that tax on the sale or purchase of goods includes '*tax on the transfer of property in goods (whether as goods or in*

[15]*supra*8, at s. 42.
[16]*supra* 11.
[17]*id*, at Art.366 (29A).

some other form) involved in the execution of a works contract.'[18]The latter part of clause (29-A) states that transfer of any goods shall be deemed to be a sale of those goods by the person making the transfer and a purchase of those goods by the person to whom such transfer is made.[19] By virtue of clause (29-A), any transfer of property in goods under sub-clause (b) of clause (29A) will be deemed to be a sale of the goods involved in the execution of the works contract. The expression '*tax on sale or purchase of goods*' carries the same meaning (as discussed above) wherever it appears in the Constitution of India. Therefore, the said expression as contained in Entry 54 of the State List includes a tax on the *transfer of property in goods (whether as goods or in some other form)* involved in the execution of a works contract.[20]The Court cited the observation of the Apex Court in *Builders' Association of India and others v. Union of India*[21], which affirmed the validity of the Amendment and accordingly held that after the Amendment it became permissible for the States to levy sales tax on the works contract involving supply/transfer of goods.

7.2 Pre-Conditions and Subject for Levy of VAT on Works Contract

The Court after referring to the decision of the Hon'ble Supreme Court in the *Larsen case*[22] reiterated the pre-conditions for taxing authorities to levy VAT on works contracts. The said pre-conditions are as follows:-

a) A works contract should exist.
b) While executing such works contract, goods should be involved.
c) The property in those goods must be transferred to a third party either as goods or in some other form.

[18]*ibid.*
[19]*supra* 11.
[20]*ibid.*
[21]*supra* 5.
[22]*supra* 2.

7.3 Building contracts are species of works contract

The Court after analyzing landmark decisions rendered by the Hon'ble Supreme Court concluded that builders are work contractors and agreement between the developer and the flat buyers to build a flat and thereafter sell the flat with some portion of land would be covered under '*works contract*'. The Court, in particular, relied in the case of *K. Raheja Development Corporation v. State of Karnataka*,[23] which had similar facts and was pertaining to issue of taxability of developers/builders under VAT.The Court held that though the activity of constructing/ building a flat is essentially a transaction of sale of flat, however, it has all the attributes of works contract. Since there will always be an element of sale of goods in a contract to build a flat, the Court came to a conclusion that building contracts will be species of the works contract.

7.4 Determining of taxable turnover relating to transfer of goods involved in the execution of works contract

Once it was settled that building contracts are works contracts, the Court went out to ascertain the principles for determination of taxable turnover pertaining to goods involved in the execution of works contract. In this regard, the Court apprehended two scenarios: a) where proper books of account are maintained by the developer, and b) when the developer does not maintain books of accounts. The Court held that in the first scenario, the charges towards service, labour and cost of land would be deducted as per the books of account. And, with regards to the second scenario the charges towards service labour and cost of land will be deducted as per the formula prescribed by the State legislature.

Further, the Court clarified that works contract will not be there when the agreement between the flat purchaser and developer is entered into after the completion of the flat. However, the element of works contract will be there when an agreement is entered into before construction has been completed and States would be empowered to impose tax on such transactions.

7.5 No Taxability on transfer of immovable property in a works contract

The Court held that while the state can tax the sale of goods element in a works contract under Article 366 (29A) (b) read with Entry 54 of State

[23]K. Raheja Development Corporation v. State of Karnataka, (2005) 5 SCC 162.

list, it cannot purport to tax the transfer of immovable property in such works contract.

7.6 Constitutional validity of Explanation (i) to Section 2(1) (zg) of the Act and Rule 25(2) of the Rules

The petitioner had challenged the constitutionality of Explanation (i) to Section 2(1)(zg) of the Act and Rule 25(2) of the Rules, since the said provisions provide for deductive method in the event of labour and services but does not provide any mechanism for exclusion of the value of land.

To examine the validity of the (i) to Section 2(1)(zg), the Court analyzed cases providing for principles of interpretation which results in sustaining the statute. The Court citing the judgment of the Constitution Bench of the Hon'ble Supreme Court in the *State of Madhya and others v. M/s ChhotabhaiJethabhai Patel and Co. and another*[24] held that, '*It is settled law that where two constructions of a legislative provision are possible one consistent with the constitutionality of the measure impugned and the other offending the same, the Court will lean towards the first if it be compatible with the object and purpose of the impugned Act*.' After relying to other cases, the Court held that rule of interpretation mandates that such meaning should be assigned to the provision which would make the provision of the Act valid and effective. Accordingly, the Court, keeping in view that said provision does not embrace within its ambit something which is prohibited by law, upheld its constitutionality.

Analyzing Rule 25(2) of the Rules, the Court stated that the 'deductive method' under the said rule provides a mechanism for deduction of charges towards labour, services and other like charges, however there is no mechanism for deduction which relates to the value of immovable property. The Court referred to the *Larsen case*, [25] wherein while considering the legality of Rule 58 of the Maharashtra Value Added Tax Rules, 2005 under similar circumstances, the Court had applied the principle of reading down a provision for upholding its constitutional validity. In light of the above case, the Court directed the State that the value of immovable property and any other thing done prior to the date of entering of the agreement of sale is to be excluded from the agreement value. Further the Court held that VAT is to be directed on

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[24]State of Madhya Pradesh and Ors. v. M/s.ChhotabhaiJethabhai Patel and Co. and Anr., AIR 1972 SC 971.

[25]*supra* 2.

the value of the goods at the time of incorporation of goods in works contract and it should not purport to tax the transfer of immovable property. Consequently, the said rule was held to be valid. However, the State government was directed to amend the rule as per the above directions.

7.7 Joint and Several Liability of developer and sub-contractor: Constitutionality of Section 42 of the Act

The petitioner had challenged the constitutionality of Section 42 of the Act, [26] wherein the works contractor/developer appoints a sub-contractor to execute the works contract. The said Section provides for joint and several liability of the contractor/developer and the sub-contractor to pay tax in respect of transfer of property in goods involved in the execution of the works contract by the sub-contractor.

While interpreting the provisions of Section 42, the Court held that tax cannot be levied on the developer in respect of the value of goods involved in the execution of the works contract on which tax has already been paid by the sub-contractor. However, it was stated that this Section will protect the interest of revenue in the event of default on the part of the subcontractor to discharge his tax liability. Accordingly, the Court upheld the constitutionality of Section 42 of the Act.

8. CRITICAL ANALYSIS OF THE JUDGMENT – MORE PITFALLS THAN PROMISE?

The present deliberation has undertaken a critical analysis of the High Court's judgment under five sub-headings. To begin with, we have addressed the issue of 'postponed agreements', i.e., agreements entered into by a builder long after accepting the payment. Then we have moved on to the 'issues in land valuation' that the judgment has failed to cover and discussed the inefficacy of not referring the disputed 'matter to a competent appellate authority'. The final heading contains a critique of the highly 'complex accounting system' that the Court has prescribed for such cases of VAT assessment.

8.1 Postponed Agreements

It is known to us that the property in goods is taxed during its incorporation into the works and not thereafter. In the present case, the

[26] *supra* 8, at S. 42.

Court has stated that a tax cannot be levied on any work before the conclusion of the agreement between a buyer and seller.[27] But a dilemma may arise if the builder books an unit in advance by accepting a certain booking amount from a buyer, with an agreement being entered into later – maybe even after one or two years. The method of valuation in such cases, pertaining to taxable turnovers, necessitates further clarification. Also, the builders do not mention the unit that has been provided to a buyer during the booking, thus making it impossible to determine if the work done has been on the booked unit. This particular issue needs elaborate addressing by the concerned authorities.[28]

8.2 Issues in Land Valuation

Further, the Court also ordered to bring in the Rules that specify the deductions of land values from the total taxable turnover. Now, an issue will rise herein when the developer does not provide the value of land categorically, as an unit is booked per square feet and no information may be procured of the per head amount that has been taken from the buyers. The practice followed by the Housing Boards is that they specify the value of land and building individually while preparing the conveyance deed, although each unit is booked according to its value per square feet. Thus the concerned authority needs to obtain beforehand the land value upon which the stamp duty has to be paid and prescribed in a conveyance deed, and in instances wherein no valuation has been mentioned would require the authority to directly assess the entire value after giving the builders a reasonable opportunity, with the matter subsequently being possibly decided by the higher Courts.

8.3 Matter to Competent Appellate Authority

It needs to be noted that the Hon'ble Court decided to set aside all revision and assessment orders without giving them a hearing on merit, after which it remanded it to the appropriate authorities to freshly adjudicate on further hearing in view of the present judgment. But, since there was not any instance with the Court to adjudicate these matters as per merit, with all provisions of the Act/Rules/instructions upheld, the cases could have been put forward before a competent appellate

[27]*supra* 1, at 45.

[28]MaliniMallikarjun and Bhupender Singh, *Includibility of land value in works contract: A Pandora's Box! – Part II*, Taxsutra, available at http://www.idt.taxsutra.com/expertprint?sid=159, (last seen on 12 October 2015).

authority – in place of setting them aside and sending them to the authorities that passed the order, thus saving time and bringing about clarity to the issue in hand.[29]

8.4 Complex Accounting System

The keeping of accounts in accordance with the Court's guidelines is difficult since it is highly complex; the lack of accurate data with the authorities preventing them from making correct VAT assessments. Such issues can only be adequately addressed when GST debuts in India. With the system we have, the best option for builders is to take the lump sum composition scheme as per Rule 49A[30] and award the work contracts to only those sub-contractors who chose such lump sum payment scheme under Rule 49.[31] Such an approach will be both cost and time effective, bringing simplicity to the structure for buyers.

9. Conclusion – The Way Forward

This case has settled the dispute regarding the liability of builders who are engaged in the business of constructing and selling constructed flats, to pay VAT. The Haryana Government has failed to realize VAT from builders since April 1, 2003 - the date from which the Haryana VAT Act was made operational. One of the major reasons attributed was the willful default of the concerned officers responsible for the implementation of the Act. The builders and developers rescued themselves from meeting the statutory requirement of paying VAT on their businesses of constructing and selling buildings, by arguing that they were engaged in selling of constructed immovable property and there was no liability of any VAT on such sales. All of this created a situation where the authorities were uncertain about the taxability on sale of constructed buildings under the VAT laws, with no clarity on the liability of the builders to pay VAT. Amidst this chaos, there was a growing need to bring clarity on this issue for the consumers who as end users are ultimately charged VAT by the builders. The aforementioned case has gone a long way in firmly establishing the basis of VAT liability for builders engaged in the business of constructing and selling flats.

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[29] *supra* 7.
[30] *supra* 10, at Rule 49A.
[31] *id*, at Rule 49.

The importance of this case lies in the fact that after the *Larsen case*,[32] this happens to be the only verdict that has explicitly mentioned building contracts to be works contracts. Further, it has improved the said decision by stating the principle that land transfer cannot be taxed under VAT or works contract. The onus thus now falls on the Haryana legislature to amend the definition of 'sale' in a manner that includes the transfer of property for goods related to immovable property while excluding the value of land for levying VAT or works contract. It is pertinent to note in this regard that the Legislatures of Uttar Pradesh, Karnataka, Delhi and Maharashtra have already amended their respective VAT Acts to exclude the value of land when valuing building contracts while levying VAT.[33]

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[32]*Supra* 2.

[33]ShammiKapoor, Hitender Mehta &Shilpa Sharma, *Punjab & Haryana High Court Holds Non-Taxability of Land Transfer in Building Contracts (Works Contract)*, Mondaq, available at http://www.mondaq.com/india/x/395246/sales+taxes+VAT+GST/PUNJAB+ HARYANA+HIGH+COURT+HOLDS+NONTAXABILITY+OF (last accessed on 02 October 2015).

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