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By

SBS and Company LLP
Chartered Accountants

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Dear Readers,

Greetings for the season!

In this edition, we bring to you certain important articles on various aspects.

The article on 'Immovable Properties vis-à-vis FEMA Regulations' is a need of hour where many were being questioned by Enforcement Directorate regarding the purchase of immovable properties in the name of non-resident by residents. This article will help the reader to understand who is eligible to purchase or inherit the immovable properties in India.

The next article is 'A Complete Analysis of Section 2(22)(e)' under the income tax laws. This is one of the sections which was there right from 1922 Act to current Act. The definition of 'dividend' has undergone various changes accommodating the dubious methods adopted by tax payers to see that dividend distribution tax not being paid. This being an anti-avoidance provision, tax payers have to strictly comply with the same. However, in this article, we tried to argue certain issues which are genuine and which in our firm's view would fall out of the phrase 'dividend'. This is purely academical and readers should take their view independently.

Another article is on 'Intermediary v Marketing Support Services' under the GST laws which tries to explain the thin line of difference between both the services. The Authority for Advance Rulings have often confused with distinction among the said services, which lead to confusion. The article attempts to list out all prominent judgments dealing with said issue and draw up a conclusion as to the distinction.

We have also authored one more article on 'Sale of Multiple Units – Rollover – Section 54', wherein we have analysed the recent Honourable Mumbai ITAT judgement. The ITAT is kind enough to accept the proposition that gains arising from sale of multiple flats and investing in single flat is not restricted under Section 54 of Income Tax Act. This re-emphasises the consistent view taken by Tribunals and other forums that the provisions of Section 54 are beneficial and does not call for strict interpretation.

I hope that you will have good time reading this edition and please do share your feedback. I will also urge clients to mail us topics or issues on which you want us to deliberate in our future editions, so that we can contribute to the same.

Thanking You,

Suresh Babu S
Chairman &Managing Partner

INCOME TAX

A COMPLETE ANALYSIS ON 2(22)(e)

Contributed by CA Suresh Babu S & CA Sri Harsha

In this piece of write-up, we aim to analyse the concept of 'deemed dividend', under the income tax laws right from the Income Tax Act, 1922 to current provisions. The said analysis is done with the support of various judgments at various forums on the said aspect. After a detailed deliberation, we wish to conclude with our views on the said concept.

Before understanding the said aspect in detail, a few basic concepts about taxability of dividend under the income tax laws would garner interest for the reader. The tax on any amounts which are declared, distributed or paid whether out of current or accumulated profits are to be paid by the company as per Section 115 O of Income Tax Act, 1961 (for brevity 'Act'). This is normally known as Dividend Distribution Tax (DDT). This is in addition to the normal income tax payable by the company and not a substitute for the normal tax.

Since the company pays DDT under Section 115 O, the shareholder is exempted from paying tax on such amounts as enumerated in Section 10(34) of Act. However, Section 10 (34) does not apply, in case where the situation is covered under Section 115BBDA, which states that where the total income of 'specified assessee' includes any income in aggregate exceeding ten lakh rupees by way of dividends declared, distributed or paid by domestic company or companies, such specified assessee has to pay income tax at 10% on such dividend income apart from the regular income tax.

With the basic understanding of the taxation of dividends, let us proceed to analyse the concept of dividend. The phrase 'dividend' has been defined vide Section 2(22) Act. The said section defines the phrase 'dividend' in an inclusive manner.

In other words, the phrase 'dividend' has to be understood in regular sense and also to be understood as specified by the said definition for the purposes of Act. The said section has five sub-clauses, certain exclusions and supported by four explanations. For ease of understanding, the definition is briefed as under:

Dividend includes

Normal distribution to shareholders to extent of accumulated profits.

Distribution to shareholders in form of debentures and any distribution to preference shareholders by way of bonus to extent of accumulated profits.

Distribution to shareholders on its liquidation to extent of accumulated profits.

Distribution to shareholders on reduction of capital to extent of accumulated profits.

Payments by company by way of advance or loan to shareholder or to any concern in which such shareholder has substantial interest or payment on behalf or for individual benefit of shareholder to extent of accumulated profits.

The intention for which Section 2(22) has been brought is candidly explained by the Honourable Supreme Court in the matter of Navnit Lal C Javeri v KK Sen 1964 (10) TMI 16 – SC[1] as under:

The companies to which the impugned section applies are companies in which at least 75 per cent. of the voting power lies in the hands of persons other than the public, and that means that the companies are controlled by a group of persons allied together and having the same interest. ***In the case of such companies, the controlling group can do what it likes with the management of the company, its affairs and its profits within the limits of the Companies Act. It is for this group to determine whether the profits made by the company should be distributed as dividends or not. The declaration of dividend is entirely within the discretion of this group. When the legislature realised that though money was reasonably available with the company in the form of profits, those in charge of the company deliberately refused to distribute it as dividends to the shareholders, but adopted the device of advancing the said accumulated profits by way of loan or advance to one of its shareholders, it was plain that the object of such a loan or advance was to evade the payment of tax on accumulated profits under section 23A.It will be remembered that an advance or loan which falls within the mischief of the impugned section is advance or loan made by a company which does not normally deal in money-lending, and it is made with the full knowledge of the provisions contained in the impugned section.*** *The object of keeping accumulated profits without distributing them obviously is to take the benefit of the lower rate of super-tax prescribed for companies. This object was defeated by section 23A which provides that in the case of undistributed profits, tax would be levied on the shareholders on the basis that the accumulated profits will be deemed to have been distributed amongst them.*

(emphasis supplied)

With the above in mind, let us proceed to analyse Section 2(22).

sub-clause (a):

The first sub-clause deals with normal dividend as everyone understands. The payments to the extent of accumulated profits are included in the definition of 'dividend' and accordingly brought into the tax net when declared, distributed or paid by the company to its shareholders.

sub-clause (b):

The second sub-clause deals with distribution of accumulated profits to the shareholders in the form of debentures or to preference shareholders in the form of bonus shares. The said payments are also called as 'dividend' and accordingly brought into the tax net when declared, distributed or paid by the company to its shareholders.

It is important to note that bonus shares issued out of accumulated profits to equity shareholders is not dividend as this clause does not cover such a situation. Further, under the sub-clause (a) or first sub-clause, the payment shall be regarded as 'dividend' only in situation where such payment entails the release of assets by company to its shareholders. In the case of bonus issue out of accumulated profits to the equity shareholders, there is no release of any assets by the company and merely reserves are transferred to capital and hence there is no 'dividend' within the meaning of the first sub-clause.

[1]The judgment was in context of Income Tax Act, 1922 where Section 2(6A) was in place of 2(22) and 23A in place of 115 O

sub-clause(c):

The third sub-clause deals with distribution to the shareholders on liquidation of the company to the extent of accumulated profits. The said payments are included in the definition of 'dividend' and accordingly brought into tax net when declared, distributed or paid by the company to its shareholders.

sub-clause (d):

The fourth sub-clause deals with distribution to the shareholders by a company on reduction of its share capital to the extent of accumulated profits. The said payments are included in the definition of 'dividend' and accordingly brought into tax net when declared, distributed or paid by the company to its shareholders.

sub-clause (e):

In the subject article, we are concerned with sub-clause (e).Hence, let us understand in detail the subject sub-clause. The bare extract is reproduced for ready reference:

(e) any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) made after the 31st day of May, 1987, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern)or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits.

On a dissection of the above sub-clause (e), the following transactions are intended to be covered:

any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) made after the 31st day of May 1987:

- *by way of advance or loan to a shareholder, being a person who is beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power, or*
- *to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern)or*

- *any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits*

Now, we proceed to analyse each of the above transactions in detail to understand the wide scope of sub-clause (e).

Advance or Loan to Shareholder:

The payment made by company, not being a company in which public are substantially interested, of any sum by way of advance or loan to shareholder, being a person who is beneficial owner of shares holding not less than ten percent of voting power is covered under the first limb of sub-clause (e).

Hence, to fall under the first limb, the following conditions has to be satisfied:

- a payment has to be made by company
- such company should not be a company in which public are substantially interested[2]
- such payment should be a sum by way of advance or loan to a shareholder
- such shareholder should be a beneficial owner of shares
- such shareholder should be holding not less than 10% of voting power

Of all the above conditions, the condition pertaining to the ownership of shares is of contentious issue. The earlier provisions till 1961 was dealing with only shareholder and not qualified by any other phrase. Hence, issues arose, about the taxability of payments in case where companies advanced loan to beneficial shareholders but not registered shareholders.

From 1988, the definition was amended to include beneficial shareholders to plug the above loose ends. However, after such amendment, the courts have interpreted that nothing has changed post amendment and taxability arises only when the shareholders are both registered and beneficial. If shareholder is either registered or beneficial, the courts have held that there would not be any tax liability on such payments made by company.

Let us examine all the crucial judgments which lead to the above conclusions. The analysis is made on a chronological basis.

Sarathy Mudaliar's case*[3]*:

This issue has first come up before the Honourable Supreme Court in the matter of CIT, Andhra Pradesh v CP Sarathy Mudaliar. The said matter was under the provisions of Income Tax Act, 1922. The phrase 'dividend' has been laid under Section 2(6A) of the said Act. The said definition has only stated that advance to a shareholder is considered as dividend and nowhere mentioned that the shareholder should be a registered or beneficial shareholder. In such context, the Honourable Supreme Court was called upon to interpret the phrase 'dividend'.

In the facts of the case, the company has advanced a loan to Hindu Divided Family (HUF). The members of HUF were the shareholders of the company. The matter before the apex court is whether loan provided to HUF which is not the registered shareholder of the company can be called as dividend for the purposes of Section 2(6A).

[2]The phrase 'company in which public are substantially interested' is defined vide Section 2(18) of Act

[3]1971 (10) TMI 8 - SC

The apex court has held the intention of insertion of Section 2(6A) on the statute book is to include certain payments which are not normally understood as dividends to be dividends. Hence, the said section requires strict interpretation. Since the definition nowhere used the phrase beneficial shareholder, it has to be understood that the definition meant only registered shareholders. Since the HUF is not and cannot be a registered shareholder of the company, the loan provided by the company to HUF cannot be called as 'dividend' since HUF is not a shareholder.

Rameshwari Lal Sanwarmal's case[4] :

Another similar matter has reached the consideration of the apex court. A company has advanced loan to the HUF. The shares in the company are registered in the name of Karta of HUF. The tax authorities have tried to tax such receipt stating that such amounts constituted 'dividend' in terms of Section 2(6A) of Income Tax Act, 1922. However, the apex court following its earlier judgment in the case of Sarathy Mudaliar, has stated that such amounts cannot be called as dividend since HUF is not a registered shareholder.

The effect of the above two judgments is that to call an advancement of loan to the extent of accumulated profits to the shareholder of company as 'dividend', the shareholder should be a registered shareholder and nothing to do with beneficial ownership of shares. Post the above two judgments, the Income Tax Act, 1922 was repealed and Income Tax Act, 1961 has been introduced. The new Act vide Section 2(22) has carried the definition of 'dividend'.

Even after the introduction of the new act, the definition of 'dividend' was still used the phrase 'shareholder' and was not qualified by any other phrase. In 1988, the said definition was amended to include shareholder who is the beneficial owner of shares holding not less than 10% of voting power. Hence, from 1922 to 1988, the shareholder has to be understood as 'registered' and not 'beneficial'. However, from 1988, such shareholder is understood as 'beneficial'.

Bhaumik Colour Private Limited's case[5] :

The matter was before a special bench of Income Tax Appellate Tribunal. The facts of the said case were Bhaumik Colour Private Limited (BCPL) took an interest-bearing loan of Rs 9 lakhs from Umesh Pencil Private Limited (UPPL). Both of the said companies do not have cross holding, however, there is one common shareholder in the both the companies, which is Narmadaben Nandlal Trust (NNT). NNT has 20% shareholding in BCPL and 10% in UPPL. The tax authorities have proposed to tax such loan as 'dividend' in terms of first limb of 2(22)(e).

The shares in BCPL were held by three trustees of NNT which had five beneficiaries. The special bench after considering the Sarathy Mudaliar's case and changes in the definition of 'dividend' from 1922 to 1988 has held that the expression 'shareholder' used in first limb of sub-clause (e) refers both to the registered and beneficial shareholder. The special bench held that if a person is a registered shareholder but not a beneficial shareholder then the provisions of Section 2(22)(e) shall not apply. Similarly, if a person is a beneficial shareholder but not a registered shareholder then also provisions of Section 2(22)(e) will not apply.

[4] 1972 (12) TMI 1 - SC

[5] 2008 (11) TMI – 273 – ITAT Bombay

In view of the facts, since NNT was not a beneficial shareholder and just a registered shareholder and accordingly the first limb fails, and no tax is required to be paid.

Ankitech Private Limited's case[6] :

In this matter also, the Honourable Delhi High Court has held as under:

Under the existing provisions of sec. 2(22)(e), payment made by way of advance or loan to a shareholder having "substantial interest" in the company was treated as deemed dividend. The shareholder having substantial interest as per provision of clause (32) of sec. 2 of the Act, was the one carrying not less than 20% voting power. In other words, earlier sec.2(22)(e) was applicable to shareholders having substantial interest in the company and the benchmark of the substantial interest was 20% of the voting power. By Finance Act, 1987, this benchmark of substantial interest was done away with. It is important to note here that section 2(32) defining the expression "person who has substantial interest in the company" was not amended. ***Therefore, to widen the scope of sec.2(22)(e), it was necessary to provide for the category of shareholders to whom the section would apply and it was provided by inserting the words "a shareholder, being a person who is beneficial owner of shares holding not less than 10% f the voting power". The concept of "voting power" was in built on the provisions of sec.2(22)(e) as it existed prior to 1987 amendment. The insertion of the words "beneficial owner of shares holding not less than 10% of the voting power" to "10% of voting power. A beneficial owner of shares cannot exercise voting power because to exercise the right to vote his/her name must appear in the register of members. In this view of the matter, it will not be correct to say that the ratio laid down by Hon'ble Supreme Court in Rameshwarlal Sanwarmal Vs. CIT 122 ITR 1 that word —shareholder in section 2(22)(e) is no more applicable. Moreover, since the purpose of sec. 2(22)(e), as stated in Circular No.495 dated 22.09.1987, is to tax the distribution of profits to shareholders, where the same is distributed not by way of dividend but by way of loan or advances, therefore, the view that word —shareholder has been used as —registered shareholder cannot be found fault with. Any other view would be against the very spirit of sec. 2(22)(e) of IT Act. The condition of 10% of the voting power is to be seen qua the shareholder; otherwise, the condition would be of no relevance.***

The Honourable High Court has concluded that in order to fall under the ambit of first limb of Section2(22)(e), the company should make a payment to a shareholder who is both beneficial and registered shareholder. The High Court has stated that the judgment of apex court in the case of Rameshwari Lal Sanwarmal is still valid post amendment too. The amendment has made it clear that shareholder should be a beneficial and it has never said he need not be registered. Hence, the apex court judgment in the case of Rameshwari Lal Sanwarmal still holds the ground post amendment since the judgment insisted that the shareholder has to be registered and not required to beneficial.

[6] 2011 (5) TMI – 325 – Delhi High Court

Madhur Housing and Development Company's case[7] :

The said matter was before the Honourable Apex Court. The Apex court after hearing the arguments made by both the parties, has confirmed the decision in the case of Ankitech Private Limited passed by Delhi High Court and agreed that the for the purposes of Section 2(22)(e) that shareholder should be both registered and beneficial and if the shareholder is beneficial and not registered, then the provisions will fail and vice versa.

National Travel Service's case[8] :

The said interpretation which was confirmed by Delhi High Court in the case of Ankitech (supra) and Supreme Court in the case of Madhur Housing and Development Company (supra), came upon for consideration again in the instant case in National Travel Service.

The apex court after considering all the above judgments has held that it will be very hard and defeating to accept the judgment in the matters of Ankitech and Madhur Housing and Development Company. The reasoning is as under:

This is why "shareholder" now, post amendment, has only to be a person who is the beneficial owner of shares. One cannot be a registered owner and beneficial owner in the sense of a beneficiary of a trust or otherwise at the same time. It is clear therefore that the moment there is a shareholder, who need not necessarily be a member of the Company on its register, who is the beneficial owner of shares, the Section gets attracted without more. To state, therefore, that two conditions have to be satisfied, namely, that the shareholder must first be a registered shareholder and thereafter, also be a beneficial owner is not only mutually contradictory but is plainly incorrect. Also, what is important is the addition, by way of amendment, of such beneficial owner holding not less than 10% of voting power. This is another indicator that the amendment speaks only of a beneficial shareholder who can compel the registered owner to vote in a particular way, as has been held in a catena of decisions starting from Mathalone vs. Bombay Life Assurance Co. Ltd., [1954] SCR 117.

The apex court has found that the judgment in the case of Ankitech (supra) and Madhur Housing and Development Company (supra) to be incorrect since the amendment has been made with an intention to bring in the beneficial shareholder into the ambit and nothing to do with the registration of such shareholder. The apex court judgment authored by Justice R F Nariman states that once a shareholder is beneficial owner, then the section attracts despite of the fact that he is not a member in the register of the company.

Based on the above reasoning, the apex court has referred to an appropriate bench to reconsider the matter of Ankitech and Madhur Housing and Development Company. Till such bench is constituted, the matter is considered, and judgment is delivered, the matter whether the first limb covers only beneficial shareholder or beneficial and registered shareholder would not attain clarity.

[7] 2017 (10) TMI 1279 – SC
[8] 2018 (1) TMI 1159 – SC

Conclusion:

In our view, the judgment in the matter of National Travel Service's case is the right exposition of the law. Once the shareholder is a beneficial owner, there is no requirement to be a registered shareholder to fall under the ambit of first limb of Section 2(22)(e), since the amendment tries to cover such shareholders who are beneficial owners and nothing to do with registration. In other words, the amendment made in 1988, is to overcome the judgments of the apex court in the case of Sarathy Mudaliar's and Rameshwari Lal Sanwarmal's. Hence, looking in that perspective, we conclude that for the purposes of first limb of 2(22)(e), the shareholder if beneficial would be enough and need not be registered.

Payment to any Concern:

The next limb under sub-clause (e), is payment to any concern in which such shareholder is a member or partner and in which he has substantial interest. Hence, to fall under the second limb, the following conditions has to be satisfied:

- a payment has to be made by company
- such company should not be a company in which public are substantially interested
- such payment should be made to any concern
- such shareholder should be a member or partner in such concern
- such shareholder who is a member or partner should have substantial interest in such concern

It is important to note that the second and third limb uses the phrase 'such shareholder'. This would mean that such shareholder who was referred in the first limb. Leaving aside the issue whether such shareholder should be a beneficial or beneficial and registered, the second limb and third limb would come into play only once a shareholder who is a beneficial owner and having not less than 10% of voting power is available. Hence, when we are dealing with second and third limb, it is important to see that the condition mentioned in the first limb as far as shareholder is concerned gets satisfied.

In addition to the above, it is important to note that the first limb covers only payments which are in the nature of advance or loan, whereas the second limb covers any payment. It is not necessary that such payments should be in nature of loan or advances. Since the payments made to any 'concern' in which such shareholder is a member or partner having substantial interest, the phrases 'concern' and 'substantial interest' assumes significance.

Such phrases are defined vide Explanation 3 of the Section 2(22). The phrase 'concern' is defined as to mean the following:

- Hindu Undivided Family
- A Firm
- An Association of Persons
- A Body of Individuals
- Company

The above is different from the definition of 'person' as laid down vide Section 2(31) of Act. The definition of 'person' covers various other species; however, the definition of 'concern' covers only limited species as detailed above.

Let us examine the ambit of phrase 'concern' by taking an example. ABC Private Limited has made a payment to ABC Society. The shareholders of ABC Private Limited are also members of the ABC Society. In such a scenario, whether such payment made by ABC Private Limited to ABC Society would fall under the second limb of sub-clause (e).

From the definition of 'concern', it is evident that 'society' has not been covered. The 'society' cannot be called as an Association of Persons or Body of Individuals and stands classified as 'artificial juridical person' as laid down by Kerala High Court in the matter of Mangalam Service Co-operative Bank Limited v Income Tax Officer[9] and Income Tax Appellate Tribunal Bangalore in the matter of Deputy Commissioner of Income Tax v Children's Education Society.

Hence, in our view, society cannot be called as 'concern' for the purposes of Section 2(22)(e), since, the said phrase does not include 'artificial juridical entity'.We also gather support from Explanation 3 vide para (b) which states that 'a person shall be deemed to have a substantial interest in a concern, other than company, if he is, at any time during the previous year, beneficially entitled to not less than 20% of the income of such concern.

From the above, it is evident that a shareholder shall be deemed to have substantial interest only he is beneficially entitled to not less than 20% of the income. Hence, we are of the view that the said definition of 'concern' covers only entities which are engaged in commercial pursuits and does not intend to cover non-profit entities. However, the said stand was not tested before any forum and hence it is advised to proceed with such caution in mind before acting.

Hence, payments made by ABC Private Limited to ABC Society, may not fall under the second limb of sub-clause (e).

Any payment on behalf, or for individual benefit:

The third limb deems any payment made by company on behalf or for the individual benefit of such shareholder as dividend. It is clear that the third limb is wider than first and second limb. It also like the second limb also covers any payment and need not be an advance or loan.

Hence, to fall under the third limb, the following conditions has to be satisfied:

- a payment has to be made by company
- such company should not be a company in which public are substantially interested
- such payment should be on behalf of such shareholder or
- such payment should be for the immediate benefit of such shareholder

[9] 2013 (7) TMI 391

Of all the three limbs, this is the trickiest one because of its ambit. As stated earlier, any payment is covered here unlike payment towards loans and advances as stated in first limb. Hence, any payment made by company on behalf of such shareholder or for the immediate benefit of such shareholder is required to be categorised as dividend for the purposes of third limb.

The phrase 'on behalf of' and 'for individual benefit' has not been defined. The said phrases need not be understood only to mean that payments are made to clear existing liabilities in light of the wider ambit of third limb.

Hence, it is important to understand the meaning of phrase 'on behalf of'. The said meaning has to be understood from the meaning of 'for individual benefit', in absence of the definition of such phrase and based on the rule of construction nosictur a sociis, which is explained as the meaning of the word is to be judged by the company it keeps.

So, we have to proceed to understand the phrase 'for the individual benefit' to understand the phrase 'on behalf of'. In order to understand the phrase 'for the individual benefit', we have to dig through the judgements and understand how courts see such phrase.

L Alagusundaram Chettiar's case[10] :

The facts in the said case are the company is advancing loans to an employee. Such employee immediately on receipt of such loan, gives loan to managing director of the company at a different rate of interest. Further, whenever the managing director wants money, the employee applies for loan to company and the same was loaned back to managing director.

The Honourable Supreme Court has held that when the company is advancing loan to an employee, who in turn, loans it to the managing director of the company, then it can be said that such loan advanced by company to employee is for the benefit of the managing director and accordingly deemed to be dividend under Section 2(22)(e).

Subhavarsha Infotech's case[11] :

Further, the Honourable Income Tax Appellate Tribunal of Chennai in the matter of Subhavarsha Infotech v The Deputy Commissioner of Income Tax has held that when a partnership firm receives loans from a company, in which partners are also directors, and such firm advancing part of the loan received from company to a wife of partner, there exists a benefit to the shareholder (partner whose wife has received loan) and accordingly deemed to be dividend. The Honourable ITAT has held that the benefit mentioned in Section 2(22)(e) need not be direct benefit to shareholder and can also be an indirect benefit like wife of the shareholder obtaining such loan.

[10](2017) 3 Supreme Court Cases 580
[11]2018 (12) TMI 522

PV John's case[12] :

The Honourable Kerala High Court in the matter of Commissioner of Income Tax v P.V.John has held that there cannot be any benefit to the shareholder when the company has gifted certain amounts to the sons of the shareholder. The Honourable High Court stated as under:

7. If these conditions are satisfied, sub-clause (e) has the effect of bringing to tax the dividend in the hands of the shareholders, three types of payments made by the company. They are: (a) any payment of any sum by way of advance or loan to a shareholder; (b) any payment on behalf of a shareholder; and (c) any payment for the individual benefit of a shareholder. All the conditions for attracting section 2(22)(e) have been satisfied, admittedly, except conditions (b) and (c) mentioned above in this case. ***If the gifts made to the sons of the assessee by the company are payments on behalf of the assessee or payments for the individual benefit of the assessee, then those gifts could be treated as deemed dividend in the hands of the assessee. Since an artificial definition has been given and a fiction has been introduced by the Legislature in enacting section 2(22)(e) to bring into the net of dividend any payments made on behalf of or for the individual benefit of the shareholder, we are directed to interpret it strictly …..***

11. For the year 1976–77, the amount gifted by the company to the son of the assessee was Rs. 1 lakh. That also was treated by the Income-tax Officer as deemed dividend on the assumption that such transfer is only on behalf of, or for the benefit of, the assessee. On first appeal, the Commissioner of Income-tax (Appeals) found that the Income-tax Officer had to prove strictly, expressly and explicitly that the payment was made on behalf of the shareholder and that no attempts have been made to show that the gift was made by the company to the son on behalf of the shareholder or for the benefit of the shareholder. ***The Revenue could have led evidence to show that the payment was made by the company to the sons of the shareholder, but, in reality, the amounts were received by the shareholder. There was no evidence to that effect. The Revenue could have proved that the ultimate destination of the amount is the father. But the facts adduced will show that the amount has been utilised by the donees for investment for their benefit. It is in that context that the reality of the gift has not been doubted by the Income-tax Officer.*** *There is no case that the payments have been made to discharge any liability of the assessee to the company. Apart from the assessee, his wife and father are also shareholders. Therefore, there is no material to show that the payments in question were made to the sons of the assessee on behalf of or for his benefit. From the relationship alone, a conclusion cannot be drawn to the effect that the payments are made on behalf of, or for the benefit of, the assessee, a shareholder. The other shareholders are the mother and grandfather of the payees.* ***In the circumstances, we hold that section 2(22)(e) of the Act is not applicable to the facts of the case and that the burden is on the Revenue to prove that the payment was made on behalf of, or for the benefit of, the assessee only. The assessee has discharged its burden of proving that the gifts were made to the assessee's sons and they have invested the amounts in their own names and also included the same in their wealth-tax returns. In fact, the Income-tax Officer did not doubt the genuineness of the transaction.***

(emphasis supplied)

[12]1989 SCC Online 575

In PV John's matter (supra), where the company has gifted amounts to sons of shareholder and revenue could not prove that such amounts were actually received by the shareholders, the payments made by company cannot be deemed as dividends. In the matter of L Alagusundaram Chettiar, it is proved that every time the managing director of the company wants certain amounts, the said amounts are advanced to employee and employee has further advanced them to managing director. In the matter of Subhavarsha Infotech, the benefit of advancing loan to wife of partner is deemed to be a benefit received by partner-cum-shareholder and held that there exists deemed dividend.

On a combined reading of the above judgments, it can be inferred that there should be a benefit, direct or indirect to the shareholder to deem the payment made by company as dividend. In absence of such benefit, the payments cannot be deemed to be dividend. Hence, the phrase 'on behalf of' also has to be understood in the same manner.

Conclusion:

In a case, where the benefit is not emanating to the shareholder, we are of the view that the third limb does not attract and accordingly the amounts cannot be held as dividend.

Concluding Remarks:

It is also important to note that vide Finance Act, 2018, the obligation to pay DDT on dividend mentioned under Section 2(22)(e) was shifted on to the company making such payments as loan/advance/any other payment. Erstwhile, such dividend was chargeable in the hands of the shareholders. However, due to challenges faced to tax such dividends in the hands of shareholder, the Finance Act, 2018 shifted the liability on to the company and tax is payable @ 30%.

As laid by the Honourable Supreme Court in the case of Sarathy Mudaliar's case, the act defines certain payments as dividends even if the said payments are not understood regularly as dividends. Hence, the section dealing with the definition of 'dividend' has to be construed strictly. On the other hand, even the Apex Court asks us to construe the provision strictly, before taking a decision whether payments would fall under the mischief of 'dividend' as per Section 2(22)(e), it is highly recommended to keep the legislative intention in the backdrop. A neat balance has to be drawn between both of them and see whether the payments are falling under the ambit of this particular anti-avoidance provision.

This article is contributed by CA Suresh Babu S & CA Sri Harsha Vardhan K, Partners of SBS and Company LLP, Chartered Accountants. The authors can be reached at suresh@sbsandco.com & harsha@sbsandco.com

INCOME TAX

SALE OF MULTIPLE FLATS - ROLLOVER - SECTION 54

Contributed by CA Ramaprasad T & CA Suresh Babu S

Section 45(1) of Income Tax Act, 1961 (Act) provides that profits or gains arising from transfer of capital asset effected during the previous year is chargeable to tax under head 'Capital Gains' and shall be deemed to be income of the previous year in which transfer takes place. This section is subject to provisions of Section 54/54B ibid etc which provides for roll over of tax provided conditions mentioned there in are satisfied.

Section 54 of the Act provides for roll over of tax in case of transfer of long-term capital asset by individual or HUF, being residential property, income from which is chargeable to tax under the head house property, and the resultant gain is invested in another residential house property within in the time frame provided there in.

The benefit of exemption under Section 54 suffered from various ambiguities namely whether the exemption is available if assessee invests in more than one residential house or such an investment should be only in India or investment of gain in a residential house property outside India is allowed.

Judiciary has expressed view that the beneficial provisions of Section 54 are available even in case the assessee invested the gain in more than one residential house[1] and also for investment in residential house located outside India[2] keeping in light the intention of Section 54 of Act.

To overcome the above judicial pronouncements pertaining to issues of investments in multiple residential properties and as well of those made outside India, Finance Act (No.2) 2014 has made an amendment by providing that the exemption under Section 54 can be claimed only on investment of gain in ***ONE*** residential house property and the same shall be situated in ***INDIA.***

This amendment takes effect from AY 2015-16 and subsequent years. Similar amendments were also made in Section 54F. After the above amendment the ambiguity of investment in multiple houses to claim exemption under Section 54 has come to an end.

However, the question that arises now is whether gain arising from sale of multiple residential properties which is invested in one residential property in India is eligible for roll over for the purposes of Section 54—

In other words, whether there is a restriction in Section 54 which prevents from investing gain in one residential property, where the gain is arising because of sale of multiple properties? For example, an assessee has 3 flats and sold them and has accumulated certain gain. Now, the assessee has invested such gain in single residential flat. Whether such investment is exempted by virtue of Section 54?

[1]D. Ananda Basappa 180 Taxman 4/ Smt. K.G Rukminiamma 8 Taxmann.com 121/Dr. Smt. P.K. Vasanthi Rangarajan 23 Taxmann.com 299

[2]Vinay Mishra 30 Taxmann.com 341

We argue that the assessee is eligible for exemption under Section 54 of the Act for the reason that the amendment has restricted investing in one residential property but there is nothing as such in Section 54 that states that gain should also arise from a single residential property.

We also gather support to our view from the recent judgment of Honourable Mumbai Tribunal in the matter of Mr Bipin N Sagar[3] . The said judgment is analysed for better understanding of the title of the subject article.

The facts of the case before the Honourable Tribunal in the matter of Mr Bipin N Sagar are as under. The assesse has sold three flats and realised a gain. Such gain was invested in the method specified under Section 54 and accordingly claimed exemption.

The Assessing Officer (AO) has issued a notice stating that assessee is not eligible for exemption under Section 54 since he has sold more than one residential house. Against such notice, the assessee has stated that at the time of purchase, there were three separate residential properties but later the said three flats were converted into a single flat. Due to certain legal formalities, the assessee has sold the three flats vide three separate sale agreements but the said three flats were always occupied as single unit. The assessee also stated that all the three flats have only electricity meter which substantiates his claim that there are no three units but only single unit.

However, AO has rejected the plea of the assessee and disallowed exemption pertaining to sale of other two flats by allowing exemption with respect to single flat. The assessee has carried the matter to the Commissioner of Income Tax (Appeals) [CIT (A)].

The CIT (A) after examining the issue on the hand, made certain subtle observations by placing reliance on the judgment of Devdas Naik[4] passed by Honourable Bombay High Court and Sh Pawan Arya[5] passed by Honourable Punjab and Haryana High Court. The CIT (A) stated that number of agreements entered by the assessee to sell the flats is not a deciding factor as to conclude whether there are three flats or single flat. What has to be seen is whether the adjoining flats were actually united and used as a common single unit or not to conclude whether sale of three flats or single flat is involved.

The CIT (A) then proceeded to state that there is no restriction placed in Section 54 which stated that exemption is allowable only in respect of single residential house property. There is an inbuilt restriction that gain arising from sale of residential house cannot be invested in more than one residential house. However, there is no restriction that capital gain arising from sale of more than one residential flat cannot be invested in one residential house.

Further, CIT (A) has held that, even if assessee sells more than one residential house in the same year and the capital gain is invested in a new residential house, exemption under section 54 cannot be denied if all other conditions are satisfied. The CIT (A) relied on the decision of Honourable Mumbai Tribunal in the matter of Rajesh Keshav Pillai[6] , wherein it was held that exemption under Section 54 shall be available in respect of transfer of any number of long-term capital assets being residential houses if other conditions are satisfied.

[3] 2019 (2) TMI 515
[4] 2014 (7) TMI 173
[5] 2010 (12) TMI 144
[6] 2010 (8) TMI 477

Based on the above reasoning, the CIT (A) has held that there is no restriction under Section 54 if gain arising from multiple long-term capital assets are invested as along as such gains are invested in single property and such property is in India. Hence, the CIT (A) have rejected the additions made by AO and accordingly granted the relief to the assessee.

The AO has preferred an appeal to Honourable Mumbai Tribunal (ITAT). The ITAT after pursing the order of CIT (A) has held that the CIT(A) has passed a reasoned order and therefore there is nothing on record to deviate from the conclusion drawn by CIT (A) and accordingly dismissed the appeal of AO.

Concluding Remarks:

As stated earlier, in our view there is nothing in Section 54 which restrict investing gain arising from multiple long-term residential properties. It was held in numerous judgments that Section 54 is a beneficial piece of legislation and needs no strict interpretation and accordingly the act of AO reading it in a stricter sense is unwarranted.

This article is contributed by CA Ram Prasad & CA Suresh Babu S, Partners of SBS and Company LLP, Chartered Accountants. The authors can be reached at caram@sbsandco.com & suresh@sbsandco.com

FEMA

IMMOVABLE PROPERTIES VIS-A-VIS FEMA REGULATIONS

Contributed by CA Murali Krishna G & CA Bharani

Introduction:

Transactions involving acquisition and transfer of immovable properties in India by non-residents are governed by Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018, which were issued vide Notification No. 21(R)/2019-RB, dated March 26, 2018 ("Immovable Property in India Regulations").

Similarly, transactions involving acquisition and transfer of immovable properties outside India by persons resident in India are governed by Foreign Exchange Management (Acquisition and Transfer of Immovable Property outside India) Regulations, 2015 which were issued vide Notification No. 7(R) / 2015-RB, dated January 21, 2016.

Both these regulations replaced corresponding earlier regulations issued in May 2000.

Along with these Regulations, such transactions are also governed by Master Direction No. 12/2015-16 on Acquisition and Transfer of Immovable Property under FEMA, dated January 1, 2016, which consolidates all the instructions and circulars issued by Reserve Bank.

For the purpose of these regulations,

a. An NRI (Non-Resident Indian) means a person resident outside India who is a citizen of India. He continues to hold Indian Passport.
b. An OCI (Overseas Citizen of India) means a person resident outside India who is registered as an Overseas Citizen of India Cardholder under section 7A of the Citizenship Act, 1955.

In parity with NRIs, OCIs have also been granted all rights in economic, financial and education fields in India except for right to acquire agricultural and plantation properties as discussed in subsequent paragraphs. OCIs are entitled to a multipurpose, multiple entry and lifelong visa allowing them to visit India at any time, for any length of time and for any purpose.

Immovable Properties In India

A. Acquisition or Transfer by NRI or OCI

Acquisition:

An NRI oran OCI may acquire immovable property in India other than agricultural land/ farm house/ plantation property either by purchase or in the form of a gift. Such gift can be from any person resident in India or an NRI or an OCI, who is a relative as per section 2(77) of Companies Act, 2013.

An NRI or an OCI may acquire any immovable in India by way of inheritance from a person resident outside India who had acquired such property (i) in accordance with the extant provisions of the foreign exchange law in force or (ii) from a person resident in India. It may be noted that restriction on acquisition of immovable property in the form of agricultural land / farm house / plantation property is not applicable acquisition in the form of inheritance.

Spouse of an NRI or an OCI, who is a person resident outside India other than an NRI or an OCI, can acquire one immovable property in India (other than agricultural land / farm house / plantation property) jointly with his / her NRI or OCI spouse, subject to condition that their marriage has been registered and subsisted for a continuous period of two years or more immediately preceding the acquisition of such property and such non-resident spouse is otherwise not prohibited for acquisition.

Transfer:

An NRI or an OCI may transfer, without prior approval of RBI, any immovable property in India to a person resident in India or transfer any immovable property other than agricultural land/ farm house/ plantation property to an NRI or an OCI.

It implies that an NRI or an OCI can transfer their immovable properties to either a person resident in India or another NRI or OCI but cannot be to any other person resident outside India.

It further implies that immovable property being agricultural land/farm house/ plantation property acquired through inheritance by an NRI or an OCI cannot be transferred to another NRI or an OCI but can be transferred only to a person resident in India.

Though prior approval of RBI is not required for transfer of immovable properties, repatriation of proceeds is subject to conditions which are discussed in subsequent details.

B. Acquisition or Transfer by other than NRI or OCI

As per Section 6(5) of FEMA, any person resident outside India may hold, own, transfer or invest in any immovable property situated in India if such immovable property was acquired, held or owned by such person when he was resident in India or inherited from a person resident in India. Accordingly, a non-resident cannot acquire any immovable property in India unless there is a change in his residential status as resident in India or it is acquired by way of inheritance. It may be noted even agricultural land / farm house / plantation properties can be acquired by such person (other than non-residents who are residing in India as a temporarily resident), as the section uses 'any immovable property'.

As per Section 6(6) of FEMA, RBI may by regulations prohibit, restrict or regulate the establishment inIndia of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business, which shall be without prejudice to the provisions of that section (ie., section 6).

Accordingly, Immovable property in India Regulations allow a branch, office or other place of business of a person resident outside India (other than liaison office) to

i. Acquire any immovable property in India which is necessary for or incidental to carrying on such business activity
ii. Transfer by way of mortgage to an authorized dealer as a security for any borrowing the immovable property acquired in pursuance to clause (i) above.

Additional Conditions:

1. Such person resident outside India shall comply with all applicable laws, rules, regulations or directions for the time being in force
2. Such person resident outside India shall file with RBI a declaration in Form IPI within 90 days from the date of acquisition. However this Form IPI is not applicable for NRIs and OCIs if they acquire such immovable properties under automatic route
3. No person being citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Hong Kong, Macau, Nepal, Bhutan or North Korea, without prior approval of RBI, shall acquire or transfer immovable property in India, other than lease, not exceeding 5 years. However, this clause is not applicable to an OCI in those countries.
4. Persons being citizens of Afghanistan, Bangladesh or Pakistan belong to minority communities in those countries residing in India on Long Term Visa can acquire one residential property for self-occupation and only one immovable property for carrying out self-employment subject to conditions specified in this regard. Such persons shall be eligible to sell the property only after acquiring Indian citizenship. Prior approval of concerned Deputy Commissioner of Police or Foreigners Registration Office is required if they want to sell before acquiring Indian citizenship.

C. Manner of Payment for Acquisition / Transfer:

1. In case of acquisition, the consideration, if any, shall be made out of (i) funds received in India through banking channels by way of inward remittance from any place outside India or (ii) funds held in any non-resident account maintained in accordance with the provisions of the Act, rules or regulations framed thereunder.
2. No payment for any transfer of immovable property shall be made either by traveler's cheque or by foreign currency notes or by any other mode other than those specifically permitted as stated above.
3. The consideration shall be paid directly to the Seller bank account and not to route it through any other person (including his relatives)
4. Payment of applicable taxes and other duties/levies in India

D. Prohibition on transfer of immovable property in India:

1. Prior approval of RBI is required for any transfer of immovable property in India by any person resident outside India, other than by an NRI or an OCI as discussed earlier.
2. Subject to directions issued by RBI, an AD Bank may create a charge on an immovable property in India in favour of an overseas lender or security trustee, to secure any loan or borrowing availed under ECB Regulations.
3. Subject to directions issued by RBI, an AD Bank may create a charge on an immovable property in India owned by an NRI or an OCI in favour of an overseas lender towards a loan availed by the company outside India in which such NRI or OCI is a director.

E. Repatriation of sale proceeds:

1. Any person resident outside India, as referred in Section 6(5) of FEMA, as discussed earlier, shall not repatriate outside India the sale proceeds of any immovable property referred to in that section (ie., property acquired when he was resident in India or inherited from person resident in India).
2. An NRI or an OCI can repatriate out of India of sale proceeds of immovable property in India, other than agricultural land / farm house / plantation property, provided the property was acquired by seller in accordance with extant FEMA regulations and amount for acquisition was paid in foreign exchange received through banking channels or out of funds held in FCNR or NRE accounts. However, in case of residential properties, the repatriation is restricted to not more than two such properties. Sale proceeds of agricultural land / farm house / plantation property can be repatriated only with prior approval of RBI, as they fall under category 1 above.
3. In the event of failure of repayment of ECB availed by a person resident in India, concerned AD Banker may permit the overseas lender or security trustee, in whose favour a charge on immovable property was created, to sell such property only to a person resident in India and to repatriate the sale proceeds towards outstanding dues in respect of said loan and not any other loan.
4. Transfer of immovable property and repatriation of proceeds thereof is subject to payment of applicable taxes and other duties/levies in India.

Immovable Properties Outside India

a. As per section 6(4) of FEMA, a person resident in India can hold, own, transfer or invest in any immovable property situated outside India if such property was acquired, held or owned by such person when such person was resident outside India or inherited from a person resident outside India. Accordingly, a foreign national who is currently a person resident in India can holds a property outside India when he was a resident outside India.
b. A person resident in India can acquire immovable property outside India by gift or inheritance from: i. Person referred in (a) above, ii. Person resident in India who had acquired such property on or before July 8, 1947 and continued to be held by him with the permission of RBI and iii. A person resident in India who had acquired such property in accordance with extant foreign exchange provisions.

c. A resident individual can send remittances under Liberalized Remittance Scheme ("LRS") for purchasing immovable property outside India (LRS limit is USD 250,000 currently).
d. A resident can acquire immovable property outside India jointly with a relative who is a person resident outside India provided there is no outflow of funds from India
e. A company incorporated in India having overseas offices, may acquire immovable property outside India for its business and for residential purposes of its staff, provided total remittances doesn't exceed the limits prescribed by RBI.
f. Any sort of acquisition other than those mentioned above would require prior approval of RBI
g. A resident can purchase immovable property outside India out of foreign exchange held in his / her Resident Foreign Currency (RFC) Account within the LRS amount.
h. There is no limit on number of properties that can be held outside India as long as such acquisitions are in line with extant FEMA guidelines. However, it should be disclosed in Income Tax Returns of such resident.
i. The resident Individuals shall not invest in Immovable Properties abroad with an intent to carry on real estate trading.

This article is contributed by CA Murali Krishna G & Bharani D Partners of SBS and Company LLP, Chartered Accountants. The authors can be reached at gmk@sbsandco.com & bharanid@sbsandco.com

GST

INTERMEDIARY VS MARKETING SUPPORT SERVICES

Contributed by CA Sri Harsha & CA Manindar

The thin line of difference between the intermediary and marketing support services is fading as time progresses in the goods & services taxes era. In this write up, we analyse the line of difference between the intermediary and marketing support services (MSS) and conclude the safe way to proceed further and also give an heads up about the impact under income tax laws.

Before proceeding further, let us step back and understand the concept of 'intermediary' under the goods & services tax laws (GST laws) and then compare with MSS and decide upon the taxability of both the said items.

Let us set the context for you to make it lively. AB Inc is a company incorporated in United States of America and engaged in manufacture of certain items. AB India is a subsidiary company incorporated in India, which is engaged in manufacture of certain items.

Now, AB Inc and AB India contemplates to enter an agreement. Both the companies sat across the table and has finalised two options.

Option 1 – Comprehensive Role to AB India:

Under this option, AB Inc contemplates to give comprehensive role to AB India for representing AB Inc in India. Vide this option, AB India will be authorised to scout for customers, make presentations to the customers, follow up on orders, negotiate the contracts, see that orders are placed on AB Inc, co-ordinate the delivery of such goods to customers, prepare invoices for AB Inc, follow up on payment for AB Inc with the customers.

The consideration for the services provided by AB India to AB Inc are settled by arriving certain percentage on the sales made by AB India on behalf of AB Inc.

Option 2 – Limited Role to AB India:

Under this option, AB Inc contemplates to give a limited role to AB India for representing AB Inc in India. The role allows AB India to promote the brand of AB Inc in India, participate in trade fairs representing AB Inc, directing any active leads to AB Inc, preparation of market survey reports and any incidental activities. AB India is not allowed/obliged to meet any customers.

The consideration for the services provided by AB India to AB Inc are settled by arriving cost plus certain mark up. The cost incurred by AB India is identified and a certain percentage is added as margin and charged to AB Inc.

Now, let us proceed to understand the concepts of intermediary and MSS and then decide the taxability of Option 1 and Option 2. Before proceeding further to understand the said concepts, we have to have in place what if a service is classified as Intermediary instead of MSS. How would the taxation differ? For this, we have to identify the place of supply and lets proceed with that.

Determination of Place of Supply:

The State in which goods or services are supplied (place of supply) as well as the state or territory in which the supplier is located (location of supplier) will form the basis to determine whether a transaction of supply of goods or services is an inter-state supply or intra- state supply. These two parameters will be decided as per the provisions of IT Act.

If the place of supply and location of supplier are in two different states/union territories, the said transaction shall be categorised as inter-state. Otherwise, the supply shall be treated as intra-state. However, there are certain exceptions to the above statements and certain supplies are mandatorily treated as inter-state supplies.

To determine the place of supply for a transaction, the Integrated Goods & Services Tax Act (IGST Act) lays two sections namely Section 12 and Section 13. Section 12 will apply in situations where the location of supplier and recipient is in India. Section 12 will apply in situations where the location of supplier or location of recipient is outside India.

Hence, we have to examine whether location of supplier (AB India) and location of recipient (AB Inc) is within India or outside India to decide on to which section has to be used for determination of place of supply.

Since AB India is located in India and AB Inc is located outside India, the appropriate section that is relevant to determine the place of supply is Section 13 of IGST Act. Section 13 has 13 sub-sections. Vide sub-section (2), the general rule for determining the place of supply is laid. If the supply does not fall in any of the sub-sections (3) to (13) [notified supplies], the place of supply shall be the location of recipient of services. If a supply falls in any of notified supplies, then place of supply of such supply shall be determined as per the relevant sub-section in which supply stands classified.

In precise terms, if the supply falls under the ambit of notified supplies, then place of supply should be determined by such sub-section. If a supply does not fall under the notified supplies, then place of supply shall be the location of recipient of services.

The place of supply for 'intermediary' is laid down vide Section 13(8)(b) which states that the location of intermediary is the place of supply. Hence, if AB India is held to be intermediary, the service shall be deemed to be consumed in India and accordingly AB India is required to pay tax on such services.

The place of supply for 'MSS' is not among the notified supplies. Hence, the place of supply shall be the location of recipient as per Section 13(2), which is outside India. Since the place of supply is outside India, the said services are treated as export of services, subject to satisfaction of other conditions.

Hence, if AB India is held as intermediary, the place of supply is in India and tax has to be paid by AB India for the services provided to AB Inc. However, if AB India is held as providing MSS or falls under the exclusion to the definition of intermediary, then place of supply is outside India and accordingly services provided by AB India are treated as export of services and not tax is required to be paid. The tax impact is 18%.

With this tax impact in background, now let us proceed to understand the concepts of 'intermediary'.

Intermediary:

Vide Section 13(8), the place of supply of certain services is fixed as the location of supplier. One of the said services is 'intermediary services'. Section 2(13) of IT Act defines the phrase 'intermediary' as '***a broker, an agent or any other person, by whatever name called, who arranges or facilitates the supply of goods*** or services or both, or securities, ***between two or more persons***, but does not include a person who supplies such goods or services or both or securities on his own account'.

From the above, it is evident any person who arranges or facilitates supply of goods between two or more persons are covered under the definition of 'intermediary'. Since AB India is arranging or facilitating supply of goods between AB Inc and customers under Option - 1, AB India can be called as 'intermediary'.
The definition of 'intermediary' excludes a person who supplies goods or services or both on his own account. The phrase 'on his own account' has neither been defined in IGST or Central Goods & Services Tax (CGST) Acts. Hence, it has to be understood from the judgments in this connection or based on the circulars or press releases issued by Central Board of Indirect Taxes and Customs (CBIC) from time to time.

CBIC Circular:

CBIC at the time of introduction of taxation based on negative list in the year 2012, has released a book by name 'Taxation of Services : An Education Guide'. Vide Para 5.9.6 the Education Guide has tried to lay down the scope of phrase 'on his own account' by referring to an example of freight forwarder. The Education Guide states that if the freight forwarder enters a contract with customer wherein, he buys and sells freight transport as a principal, then the freight forwarder would be stated that he is acting in his own account. However, if the freight forwarder arranges the facility of freight without actually entering a contract with the customer, then the freight forwarder is called as an 'intermediary'.

GoDaddy's case:

The interpretation of 'intermediary' has also come up in the matter of GoDaddy India Web Services Private Limited v Commissioner of Service Tax, Delhi - IV[1] before the Authority for Advance Rulings. The facts of the said case are GoDaddy Inc is contemplating to enter an agreement with GoDaddy India, whereby GoDaddy India is to provide support services in an integrated manner to assist GoDaddy Inc to develop its brand in India, carry on its operations efficiently and serve customers in India. GoDaddy India has to provide marketing and promotion services, supervision of quality of third-party customer care centre services and payment processing services.

The tax authorities have opined such services provided by GoDaddy India to GoDaddy Inc are in the nature of 'intermediary' services and hence taxable in India. The Authorities after examining the proposed agreement between GoDaddy Inc and GoDaddy India stated that GoDaddy India is engaged in providing business support services to GoDaddy Inc and there is no contract between GoDaddy India and customers of GoDaddy Inc in India. GoDaddy provides services directly to GoDaddy Inc and not to its customers. Further, the payments were received from GoDaddy Inc and not from its customers and hence the Authority has held that services provided by GoDaddy India are not in the nature of 'intermediary'.

[1] 2016 (3) TMI 355 – AAR

Global Transportation Services Private Limited's case:

The said concept 'on his own account' is well explained in the matter of Global Transportation Services Private Limited v Commissioner of Service Tax Mumbai [2] by the Authority for Advance Rulings. In the facts of the said matter, the applicant is providing various services to its customers by entering individual contracts with various vendors. The applicant independently contracts with various vendors and provide such services to its Client. If there is a damage, the applicant will have right to sue the vendor and the Client will have right to sue the applicant. In such circumstance, the tax authorities argued that the applicant is an 'intermediary' because he is facilitating or arranging the services between his client and vendors. The applicant stated that he is excluded from the definition of 'intermediary' since he is supplying the services on his own account.

The Authority of Advance Ruling after making reference to the terms of the contract has stated that the applicant is acting on his own account and it cannot be said that applicant is acting as an intermediary for the only reason that the price which is to be paid by the Client is negotiated by the applicant with vendor and hence for this reason alone, the applicant cannot be said that he is facilitating or arranging the services between the Client and vendor. Accordingly, it was held that applicant is engaged on his own account and not as an 'intermediary'.

In light of the above, we have to understand the phrase 'on his own account'. In other words, if the activities of the person are in the nature of principal to principal, then it can be said that such person is providing services or goods on his own account. However, under Option -1, AB India facilitates or arranges the supply of goods from AB Inc to customers in India. Hence, it cannot be said that the AB India is acting on principal to principal basis. There is an agency relationship between AB India and AB Inc for the reason that one of the primary objects of AB India is also to procure orders from AB Inc.

Sabre Travel Network India Private Limited's case:

We also gather support from the recent judgment in the matter of Sabre Travel Network India Private Limited (Sabre India) passed by Authority for Advance Ruling, Maharashtra [3], wherein it was held that applicant' services of scouting for customers for parent company cannot be called providing services on his own account. The relevant paras from the said judgement are reproduced hereunder for ready reference:

From the facts before us we find that the applicant is covered by the said definition of an intermediary because ***they are definitely acting as a broker/ agent, etc and facilitating the process for sale of CRS Software belonging to their foreign parent company, to the Indian subscribers because they identify such subscribers on their own in India. It is the sales team of the Applicant which approaches potential subscribers in India to whom they explain the features of the CRS Software and the flexibility of said software to integrate with the potential subscriber's system for smooth functioning.*** *Once the applicant gets a positive response from the subscriber, they scan the credentials and the business potential of the subscriber to whom it is proposed to market the CRS Software…..*

[2] 2016 (9) TMI – AAR
[3] 2018 (12) TMI – AAR, Maharashtra

Thus from the above we find that first and foremost it is the job of the applicant to scout for subscribers in India. It is nowhere mentioned that the subscribers come on their own to the applicant. Thus the applicant explains and educates the subscriber about the software. Hence it is clear that the subscriber becomes aware of the software only after the applicant approaches them. It is also mentioned that the software does not belong to the applicant. Thus we find that the applicant actually acts as an Intermediary between the potential subscriber and Sabre APAC. The applicant is not providing services on their own.

Mrs Vishakhar Prashant Bhave, Micro Instruments case:

In the matter of Mrs Vishakhar Prashant Bhave, Micro Instruments[4] , it was held that the applicant is acting in capacity of broker and facilitating the process for sale of materials by their foreign principals to Indian parties for the reason they locate the customer, negotiate the prices and probably ensure the sale, they also provide for discounts to the said customers, out of the commissions received by them and hence the services provided by the applicant are in the nature of 'intermediary'.

Vserveglobal Private Limited's case:

In addition to the above, in the matter of Vserveglobal Private Limited [5], the Authority for Advance Ruling has held that applicant who is engaged in provision of back office administrative and accounting support and co-ordination with buyers, sellers and other necessary parties for execution of purchase and sale contracts entered by their clients and other incidental services are in the nature of 'intermediary' services.

Asahi Kasei India Private Limited's case:

In the matter of Asahi Kasei India Private Limited [6], the Authority for Advance Ruling has held that applicant who is engaged in provision of marketing support services to its holding company are not to be considered as 'intermediary' services. The authority has also held that relationship between the parties is that of independent contractors and the agreement does not intend to create a principal and agent relationship. The applicant shall not represent itself to be agent and vice versa. On the contrary, the applicant would provide services on own account to its holding company so that the latter can improve the functioning of holding company and further augment its business vis-à-vis sale of all products manufactured or sold.

The authority further held that the applicant no way carries out activities such as conclusion of contracts, acceptance of sale orders, invoicing, determination of sale prices and like services. Hence, the said services provided by applicant to its holding company are not in the nature of 'intermediary' services since they are provided on his own account.

[4]2018 (12) TMI 227 – AAR Maharashtra
[5]2018 (11) TMI 959 – AAR Maharashtra
[6]2019 (1) TMI 1091 – AAR Maharashtra

Conclusion:

From the above, it is evident that if AB Inc enters an agreement as mentioned in Option – 1, the said services will be called as 'intermediary' and accordingly taxable in India in the hands of AB India. Option – 1 provides a comprehensive role to AB India and it creates an agency relationship with AB Inc and undoubtedly falls under the definition of 'intermediary'.

However, if AB India enters agreement in Option – 2, whereby assumes a limited role, then it can be said that AB India does not fit into the definition of 'intermediary'.

Hence, from the above discussion, it is evident that there is only a thin line of difference between 'intermediary' and 'marketing support services' and certain AAR's stumbled to arrive at right conclusions. We suggest drafting the agreements detailing the exact scope of services in clear way to avoid any future litigations. It is also important to note that tax paid on intermediary services would not be eligible as credit as such service is under forward charge and not under reverse charge.

Passing Remarks – Income Tax laws:

The agreement entered between AB India and AB Inc will also have implications under income tax laws. If the agreement entered is under Option -1, there is every possibility that AB Inc having a permanent establishment (PE) in India in form of agency through AB India. If agreement entered is under Option -2, the said services might not constitute PE in India. What constitutes a PE in India or not depends upon the Double Taxation Avoidance Agreement that India has with such other country. The above is based on general understanding of the treaties with majority of the countries and need not represent the final view.

This article is contributed by CA Sri Harsha Vardhan K & CA Manindar K, Partners of SBS and Company LLP, Chartered Accountants. The authors can be reached at harsha@sbsandco.com & manindar@sbsandco.com

By

Team SBS

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Hyderabad: 6-3-900/6-9, #103 & 104, Veeru Castle, Durganagar Colony, Panjagutta, Hyderabad, Telangana
Kurnool: No. 302, 3rd Floor, V V Complex, 40/838, R.S. Road, Near SBI Main Branch, Kurnool, Andhra Pradesh
Nellore: 16-6-259, 1st Floor, Near Santi Sweets Opp: SBI ATM, Vijayamahal Centre, SPSR Nellore, Andhra Pradesh
Sri City: Sri City Trade Centre, Ground Floor, Suite No 102, 2880, Central Expressway, Sri City Post, Tada, A.P - 517 646
Visakhapatnam: # 39-20-40/6, Flat No.7, Sai Yasoda Apartments, Madhavadhara,Visakhapatnam (Urban),Vizag, Andhra Pradesh
Bengaluru: B104,RIRCO, Santosh Apartments, Wind Tunnel Road, Murugeshpalya, Old Airport Road, Bengaluru , Karnataka.

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