Tax Matters

Issue No. 2023/12 Date: 15 January 2024

The team at JMP Advisors is pleased to bring to you a gist of some of the significant developments in the direct tax space during December 2023:

Income tax rulings

- **Interest at the rate of 6% on the excess tax paid under the Equalisation Levy**

  - Group M Media India (P.) Ltd. v Deputy Commissioner of Income-tax[1]

The taxpayer had availed specified digital services on which Equalisation Levy ('EL')[2] was applicable. The taxpayer had initially deposited the Equalization Levy under Section 164 of the Finance Act of 2016 (FA Act 2016). Subsequently, a revision in the EL amount led to the taxpayer being eligible for a refund of the excess amount.

Despite reminders, the tax officers failed to release the undisputed refund along with interest, prompting the taxpayer to approach the Bombay High Court ('Bombay HC'). Upon filing the petition before the HC, the department refunded the excess amount of EL. However, no interest was paid on the same stating that the FA Act did not provide for interest on refund of EL.

The taxpayer before the Bombay HC contended that Section 170 of the FA Act 2016, mandates interest payment for delayed crediting of the levy to the government and therefore interest should be paid for the excess tax paid. The tax officer contended that the said section does not specifically provide for interest on excess tax paid and hence same should not be granted.

The Bombay HC relying on the Apex Court judgement in case of Union of India v. Tata Chemicals Ltd[3]. held that a tax refund constitutes a debt owed and payable by the government. It stressed that interest serves as compensation for the unauthorized retention and use of the deposited funds.

Rejecting the tax-officer's argument against the provision of interest, the Bombay HC awarded interest at a rate of 6% per annum on the refunded amount, aligning with Section 244A of the Act.

***JMP Insights** – This is a welcome judgement for the taxpayer as it establishes the right to interest on Equalization Levy refunds and provides a thorough legal analysis, citing pertinent judicial precedents. The ruling underscores the duty of tax-officers to promptly reimburse taxpayers with interest for any undue retention of funds, setting an important precedent for similar cases.*

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[1] Writ Petition (L) NO.12786 OF 2023 (Bombay HC)
[2] Equalisation Levy Rules 2016
[3] (2014) 43 taxmann.com 240

➢ Explanation 6 and 7 to Section 9(1)(i) to be applied retrospectively

- Commissioner of Income Tax v Augustus Capital Pte Ltd[4]

The taxpayer, a Singapore based entity had earned long term capital gains on account of sale of equity shares of another foreign company to an Indian company. The taxpayer had filed its ROI declaring NIL income, taking cover of Explanation 7 attached to Section 9(1)(i) of the Income Tax Act, 1961 ('Act') and claimed refund of taxes withheld by the Indian buyer.

As per Explanation 7, income will not be deemed to accrue or arise in India if the transferor does not have management or control rights in the company whose shares are sold and holds less than 5% of voting rights in such company. In the present case, taxpayer held only 0.05% ordinary shares and 2.93% of preferential shares in the company and the taxpayer had no management rights in the company.

However, the tax officer taxed such capital gains on the grounds that Explanation 7 was inserted in the law during subsequent tax year and thus not applicable.

The tax officer has relied on various case laws supporting their stand and held that:

i. Law to be applied which is in force unless provided otherwise
ii. If any amendment, being clarificatory in nature, brings about a change in law, it cannot be presumed to be retrospective in nature
iii. Explanation 6 and 7 introduce new set of exemptions for small taxpayers and therefore apply prospectively
iv. Explanation 6 and 7, unlike Explanation 5, do not expressly state they would operate retrospectively

However, the Delhi High Court ('Delhi HC') held that the amendments introduced vide Explanations 6 and 7 to be curative in nature. Expressions 'share and interest' and 'substantially' found in Explanations 4 and 5 are vague resulting in undue hardships for transferors. Therefore, introduction of Explanations 6 and 7 is to cure the unintended consequences flowing from Explanations 4 and 5. Explanations 6 and 7 are not standalone provisions and need to be read along with Section 9(1)(i) and Explanations 4 and 5 as a whole.

The taxpayer has relied on the judgement of the coordinate bench in case of Copal Research Ltd, Mauritius[5] which was before the introduction of Explanations 6 and 7. The Delhi HC in that judgement held that the expression "substantially" occurring in Explanation 5 would necessarily have to be read as synonymous to "principally", "mainly" or "majority".

Relying on the above, Delhi HC in this case ordered in favour of the taxpayer and concluded that Explanation 6 and 7 would apply retrospectively.

JMP Insights – *The judgement of the Supreme Court rendered in the case of Vodafone International Holdings B.V excluded from the scope and ambit of section 9(1)(i) gain or income arising from the transfer of shares of a company located outside India. To cure this gap in the legislation, Explanations 4 and 5 were introduced via the Finance Act 2012 to cover situations where the value of the shares was dependent on assets situated in India. However, due to the vague expressions used in Explanations 4 and 5, Finance Act 2015 inserted Explanations 6 and 7.*

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[4] ITA No. 405/2022 (Delhi HC)
[5] (2014) Taxmann.com 125

The decision clarifies the taxation of gains from transferring foreign shares with value linked to Indian assets. This provides greater certainty for small investors.

The court distinguishes between clarificatory and substantive amendments to tax laws. While amendments are generally not applied retrospectively, curative amendments i.e., clarifications removing ambiguities do not suffer the same limitations.

This ruling sets a precedent for applying clarifications like Explanations 6 & 7 retrospectively, especially when addressing ambiguities and preventing unintended consequences for taxpayers.

- **Ruling on constitution of PE for US based Company**

  - M/s EXL Service.Com Inc v The Addl. DIT[6]

The taxpayer, a US based company is engaged in business of developing and deploying business process outsourcing solutions and internet/voice-based customer service for its clients based in USA and UK. The taxpayer entered into service agreement with its 100% Indian subsidiary company for providing internet and voice-based customer support services and backroom operation services at a pre-determined hourly rate.

The tax officer held the Indian subsidiary to be a Permanent Establishment ('PE') of the taxpayer as per Article 5 of India USA DTAA and the income is taxable under Section 9(1)(i) of the Act under the following grounds:

v. Majority portion of service is undertaken in India
vi. Substantial portion of revenue is earned in India but retained by the taxpayer
vii. Facilities of Indian subsidiary is a fixed place of business of the taxpayer
viii. Taxpayer is dependent on Indian subsidiary to execute the contracts
ix. Facilities of Indian subsidiary is at the disposal of taxpayer
x. Indian subsidiary is owned, controlled, operated and managed by the taxpayer

The Tribunal relied on the Landmark rulings in case of eFunds IT Solutions and Ors[7] and Formula One World Championships Ltd[8] while deciding on the issue of constitution of PE in India held the following:

i. **On the issue of Fixed place PE**, the Tribunal held that the fixed place should be at the disposal of the taxpayer and the business of the taxpayer should be carried out from such fixed place wholly or partly. However, merely giving access to such a place would not suffice and the taxpayer must have control and the right to use the said place. The Tribunal further held that taxpayer being major shareholder had the legal right to nominate a director on the board of its subsidiary and mere nomination of director would not mean that taxpayer has place of management in India. Accordingly, the tax officer has erroneously treated the 100% subsidiary as a fixed place PE.

[6] ITA No. 4183/DEL/2013
[7] 399 ITR 34 (SC)
[8] 394 ITR 80 (2017) (SC)

ii. **On the issue of Service PE**, the Tribunal held that the taxpayer must furnish services within India through employees or other personnel. In the present case, there was no case of secondment of employees by the taxpayer to its Indian subsidiary and therefore, question of constituting service PE in India does not arise.

iii. **On the issue of Agency PE,** the Tribunal relying on the Supreme Court ruling in case of Morgan Stanley & Co[9] held that an agency PE is formed when the Indian subsidiary is acting on behalf of the taxpayer and the Indian subsidiary has authority to conclude contracts on behalf of taxpayer. Since Indian subsidiary does not have any authority to conclude contracts on behalf of the taxpayer and all customers are based out of US and none of them are located in India, no agency PE is formed in India.

Based on the above, Tribunal held that taxpayer does not have a PE in India. For the sake of completeness, the Tribunal further clarified that as per India USA DTAA, only that income which is attributable to the PE in India is taxable in India. Relying on the Supreme Court ruling in case of Morgan Stanley (supra), the Tribunal held that if the transactions between the PE and the foreign Associated Enterprise have taken place at arm's length prices, there is no question of attributing any income to the PE.

JMP Insights – *The tax officer has erroneously treated the 100% subsidiary to be a Permanent Establishment of the taxpayer. In absence of employees seconded to India combined with absence of customers in India, the Tribunal has dispelled the notion of the taxpayer constituting a PE in India. The ruling further clarifies that, if transactions are at arm's length prices, there is no need to attribute income to the PE.*

This favourable decision establishes a significant legal precedent providing valuable insights for navigating cross-border taxation challenges.

Circular and Notification

- **CBDT Circular No 20 of 2023 - Guidelines for TDS on E-commerce operators/Online Businesses:**

  The Finance Act, 2020 introduced section 194-O, requiring E-Commerce Operator ('ECO') to deduct 1% tax of the gross amount of sale of goods or provision of services or both from the payment made to the seller.

  The Circular addresses critical issues in Tax Deduction at Source ('TDS') compliance within the e-commerce sector, providing guidance on the following key areas:

  1. **TDS in Multiple ECO Transactions**: In transactions involving multiple ECOs, compliance with section 194-O depends on whether the seller-side ECO is the actual seller.
     a. Where the seller-side ECO is not the actual seller, then TDS compliance is to be done by the seller-side ECO who finally makes payment to the seller.
     b. Where the seller-side ECO is the actual seller, then TDS compliance is to be done by ECO who makes payment to such seller-side ECO (who is the seller).

[9] 292 ITR 416 (SC)

2. **Inclusion of Various Fees in Gross Amount:**
   a. Convenience fees, commissions, logistics charges, and delivery fees are to be considered in the gross amount for TDS purposes.
   b. Payments to platform providers for transaction facilitation are included if directly linked to the transaction.

3. **Exclusion of GST and Other Taxes:** TDS shall occur at the earlier of payment or credit to payee's account.
   a. In case, payee's account is credited prior to making payment, then TDS shall be applied on the amount excluding GST and other taxes.
   b. In case, payment is made prior to crediting payee's account, then TDS shall be applied to the entire amount.

4. **Purchase Returns and Adjustments:**
   a. In case of purchase return, TDS can be adjusted against the next transaction with the same seller in the same financial year.
   b. No adjustment is necessary if the purchase return is replaced by goods.

5. **Treatment of Discounts:**
   a. **Seller discount**: Where discount is offered by the seller itself, then TDS shall be applied on the amount receivable from the buyer.
   b. **Buyer ECO or Seller ECO Discount**: Where discounts are offered by one ECO to another, then TDS shall be applied on the amount of sale consideration paid to seller.

***JMP Insights** – The circular aims to provide clarity on the TDS compliance in the e-commerce sector, offering guidance on multiple ECO transactions, fees inclusion, GST treatment, purchase returns and discount deduction.*

DID YOU KNOW?

The Income Tax Department has issued a notification amending Safe Harbour Rules. Rule 10TA is amended refining the definition of intra-group loans granted by Indian companies. The condition of sourcing the loan in Indian rupees has been removed. Rule 10TD is amended to adjust the interest rates for advancing intra-group loans denominated in foreign currency based on credit ratings. The above amendments shall be applicable with effect from 1 April 2024 (i.e., Tax year 2024-25).

Should you wish to discuss any of the above issues in detail or understand the applicability to your specific situation, please feel free to reach out to us on coe@jmpadvisors.in.

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