Tax Matters

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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 March 2022:

Income tax rulings

- **Remuneration from a partnership firm by an individual not be included in 'Gross receipts' for the purpose of computing the limit for tax audit**

  - Perizad Zorabian Irani [Bombay High Court ('HC')] [Writ petition No. 1333 of 2021]

The taxpayer, an actor by profession, was also a partner in two partnership firms. During Financial Year ('FY') 2016-17, her income from the acting profession was ~INR 8.45 lakh. In addition, she had also received remuneration of ~INR 1.01 crore as a working partner from the two partnership firms.

The tax officer treated the return to be invalid as the tax audit of the books of accounts was not done, even though the gross receipts exceeded the specified limit.

The taxpayer filed a revision application before the Commissioner of Income Tax ('CIT') against the order of the tax officer. The CIT concurred with the tax officer's view. The taxpayer then filed a writ petition before the Bombay HC.

The Bombay HC held that 'Profession' is defined under the Income-tax Act, 1961 ('the Act') and includes vocation. Remuneration received from a partnership firm is not construed as Profession and will not be included in gross receipts from the profession. Reliance was placed on the Madras HC judgement in the case of *Anandkumar vs. Assistant Commissioner of Income Tax (2021) 430 ITR 391 (Mad.),* where it was held that remuneration and interest from partnership firms cannot be treated as gross receipts from business as the individual was not carrying any eligible business.

***JMP Insights** – While the Bombay HC has ruled in favour of the taxpayer in this case, it is worth noting that remuneration from a partnership firm may not be permitted to be taxed under presumptive basis and the normal provisions for computing income under the head Profits and Gains from Business and Profession shall apply.*

- **Holding company, acting as a guarantor for the purchase of shares undertaken by its Wholly Owned Subsidiary ('WOS'), not liable for withholding tax on the payment made by the WOS.**

  - Ingram Micro Inc. (Bombay HC) [Writ Petition No. 974 of 2014]

Taxpayer's WOS acquired the shares of a Bermuda-based company, which indirectly held shares of an Indian company. The taxpayer was a guarantor to the share purchase agreement entered into by its WOS.

The tax officer issued notice to the taxpayer that it was required to withhold tax while making payment under section 195 and since it had failed to withhold tax, it was deemed to be an 'assessee in default' under section 201(1) of the Act.

The Bombay HC has held that where the taxpayer was merely a guarantor to the share purchase agreement entered into by its WOS, it cannot be held liable for not withholding tax on the payment made for the purchase of shares. The obligation to withhold tax under section 195 of the Act is on a person responsible for paying to a non-resident. If the actual consideration was discharged by its WOS, then the tax officer's assumption that the taxpayer as the ultimate beneficiary of the acquisition of shares was required to withhold tax, was not correct. If the ultimate beneficiaries of the transaction were to be considered, then it would be the shareholders of the taxpayer and not the taxpayer.

The Bombay HC further observed that for understanding the acquisition, the tax authorities have merely relied on the taxpayer's annual report, which was in fact of the group and not of the taxpayer on a standalone basis. WOS being a separate legal entity, the actions of WOS cannot be presumed to be the actions of the taxpayer.

***JMP Insights** – Section 195 of the Act fastens the liability of withholding tax on any person who is responsible for paying to a non-resident. The HC re-emphasised on the independent status of a WOS. The liability to withhold tax cannot be shifted to the holding company on the presumptions that WOS had entered the transaction for the benefit of the holding company.*

- **Expenses proved to be integral to business operations cannot be disallowed as unexplained expenditure, the need for secrecy requirements to be considered on facts.**

  - EIPR India Pvt. Ltd (Mumbai Tribunal) [ITA No. 7471/MUM/2018]

The taxpayer was engaged in the business of investigation for violation of Intellectual Property Rights ('IPR'). The Mumbai Tribunal has ruled that informer expenses cannot be disallowed, if it is satisfactorily proved that the expenses are integral to the operations carried out by the taxpayer and actual payment of these expenses has been substantiated. The Tribunal also held that the requirement of maintaining secrecy about the identity of the informers needs to be recognised as a unique aspect of the nature of business carried on by the taxpayer The expenses cannot be regarded as 'unexplained' for this reason.

The Tribunal further held that expenses for earning exempt income cannot be disallowed when there is no exempt income actually earned, and expenses on foreign travel by the Director of the taxpayer cannot be disallowed, when it was sufficiently established that the personal travel expenses had been segregated and separately charged to the capital account of the Director.

***JMP Insights** – Maintenance of secrecy about the recipients of payment made by the taxpayer may not necessarily lead to the expense being classified as 'unexplained expenditure', depending on the facts of the case, such as the nature of business of the taxpayer, other statutory provisions requiring maintenance of secrecy, and so on.*

Further, while the Tribunal has allowed the expense incurred for earning exempt income on the grounds that no exempt income was actually earned, the recent amendment vide the Finance Act, 2022 on this would mean that such expenses will now be disallowed.

- **Factory of the JV in India cannot be construed as Permanent Establishment ('PE') for the foreign company, in the absence of 'control' over premises.**

  - FCC Co. Ltd (Delhi Tribunal) [ITA No. 8960/Del/2019 and ITA No. 54/Del/2019]

The Delhi Tribunal has held that the premises of the Joint Venture ('JV') entity of the taxpayer cannot qualify as a Fixed place PE for the taxpayer, merely because the personnel of the taxpayer are present at the premises to render services to the JV entity. It was observed by the Tribunal that the premises were neither under the control of the taxpayer nor at the disposal of the taxpayer, other than for rendering agreed services to the JV entity. The business of the taxpayer is not being carried out through the premises of the JV.

It was further held by the Tribunal that to constitute a Supervisory PE, it needs to be established that the personnel of the taxpayer are supervising an installation, assembly or construction project. as envisaged in the India Japan Double Taxation Avoidance Agreement ('DTAA'). Since the personnel of the taxpayer were engaged in providing technical assistance in the manufacturing process as per the agreement with the JV entity, the taxpayer does not constitute a Supervisory PE.

***JMP Insights** – One of the arguments before the Tribunal was that Supervisory PE can be constituted only if supervision is in connection with a building site or construction, installation or assembly project. The JV was in the business of manufacture and assembly of clutches. The actual assembly of clutches should not be confused with the supervision of assembly project, as envisaged in Article 5(4) of the India Japan DTAA. Further, technical services rendered by the taxpayer could be considered for the establishment of a Service PE. However, since there is no Service PE clause in the India Japan DTAA, this question was only academic.*

- **Indian distributor of a Mauritian company does not constitute a Dependent Agent Permanent Establishment ('DAPE') as Revenue failed to establish its existence.**

  - Taj TV Limited (Mumbai Tribunal) [ITA No. 6588 & 6741/Mum/2019]

Taxpayer was a foreign company registered under Mauritian Law and is engaged in the business of telecasting its sports channel – 'Ten Sports'. The taxpayer had appointed an Indian company to distribute television programming service to cable systems for exhibition to subscribers in India. The Taxpayer had also appointed the Indian company as its advertising and sales agent, to sell commercial advertisement time and to collect advertisement charges from India exporters on its behalf. The taxpayer did not have any branch or office in India.

Distribution revenue

The taxpayer earned distribution income for telecasting of 'Ten Sports'. The Tribunal observed that there was a clause in the agreement where the authority of concluding the contract has been given to the Indian company. It held that to fall under the DAPE under the relevant Article of the DTAA between India-Mauritius, two conditions have to be satisfied i.e., having an authority to conclude the contracts and habitual exercise of such authority. Relying on the Special Bench ruling in the case of *Motorola Inc. v Dy. CIT [(2005) 95 ITD 269],* the Tribunal held that the DTAA is an alternate tax regime and not an exemption regime. The onus to prove that the taxpayer has a taxable income is first on the tax department; failing to do so, the taxpayer cannot be assumed to have a DAPE in India.

Advertisement revenue

Relying on the co-ordinate bench ruling in the taxpayer's own case for earlier years, the Tribunal held that since the Indian company was remunerated at arm's length price, no further profit was required to be attributed for the purpose of taxation in India. The Tribunal left the issue of the existence of PE with respect to advertisement income open.

Transponder fees and uplinking charges

The Tribunal, relying on rulings by the co-ordinate bench in the taxpayer's own case held that the transponder fees and uplinking charges paid to a tax resident of the USA are not in the nature of royalty within the meaning of Article 12 of the India-USA DTAA. Accordingly, it ordered the deletion of the disallowance of the expenditure by the tax officer.

***JMP Insights** – The judicial principle followed by the Tribunal in this case is that once an arm's length remuneration is paid to the Indian entity, nothing further survives for taxation in its hands, effectively making the existence of a DAPE in India tax neutral.*

Circular

- **Central Board of Direct Taxes ('CBDT') allows condonation of delay for filing Form 10-IC**

  Companies availing the benefit of the lower rate of tax of 22% under the provisions of the Act must submit Form 10-IC on or before filing the Return of Income ('ROI') for FY 2019-20. Failure to furnish such an option in the prescribed form results in the denial of the concessional rate of tax.
  The CBDT vide Circular No. 6/2022 dated 17 March 2022 has condoned the delay for FY 2019-20 where the following conditions have been satisfied:

  - The ROI for FY 2019-20 has been filed on or before the due date of filing the ROI;
  - The company has opted for availing the benefit of the lower rate of 22% in the 'filing status' in 'Part-A-GEN' of the Form ITR-6;
  - Form 10-IC should be filed electronically on or before 30 June 2022.

DID YOU KNOW?

The Central Board of Indirect Taxes and Customs has, vide Notification No. 01/2022-Central Tax dated 24 February 2022, reduced the turnover threshold for mandatory e-Invoicing, from INR 50 Crore to INR 20 Crore, with effect from 1 April 2022.

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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