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 February 2023:

Income tax rulings

- **Tax Residency Certificate ('TRC') is a sufficient and valid document to claim benefit of Tax Treaty.**

  - Blackstone Capital Partners (Singapore) VI FDI Three Pte. Ltd[1]

The taxpayer, a Singapore resident, acquired equity shares of Agile Electric Sub Assembly Private Ltd ("Agile") during FY 2015-16 and subsequently sold all the equity shares of Agile to Igarashi Electric Works Ltd. ("Igarshi") and other parties during the FY 2017-18. The Taxpayer claimed that the capital gains arising from the Transaction were not taxable in India in light of Article 13(4) of the India-Singapore Double Tax Avoidance Agreement ("DTAA") based on the TRC. The return of income was processed with no demand. Thereafter, a notice for reopening was issued under section 148 of the Income Act, 1961 ('the Act') and the taxpayer has requested for the reasons to recompute the income. The taxpayer contended that re-opening of case based on information received from another department of the tax authorities was bad in law and the taxpayer filed a writ petition in the Delhi High Court ('HC').

The HC held that issuance of a notice based on 'borrowed satisfaction' is impermissible in law. The tax officer has done a 'cut and paste' job without any application of mind or investigation. Information from a third party can form basis for examination/investigation but the decision to reopen any case should be of the tax officer and not the third party. In light of this, the HC held issuance of such a notice to be legally impermissible.

The High court held that concept of beneficial ownership is not applicable to capital gains as the words in the DTAA are clear and refer to the legal ownership and not beneficial ownership. If the intention were to tax beneficial ownership the same would be mentioned in the Article of the DTAA. Additional pleas cannot be raised as these were not a part of the initial reasons of reopening the case.

On perusal of the audited financial statements of the taxpayer and an independent chartered accountant's certificate, the HC held that the taxpayer was satisfying the LOB condition provided in the DTAA.

The HC relying upon the relevant notifications, circulars, and judicial precedents has drawn the conclusion that it would be bad in law to disregard the TRC issued by another

[1] Blackstone Capital Partners (Singapore) VI FDI Three Pte. Ltd. W.P.(C) 2562/2022 & CM Appl. 7332/2022

country as that is contrary to the International Law and against the intention of the policies of the Government of India. Further, no document is produced by the tax officer to show that the taxpayer is a resident of United States of America ('USA') and is controlled and managed from USA and thus the taxpayer, being an investment fund which is governed by and complying with the laws of Singapore is resident of Singapore and not USA.

JMP Insights *– The HC judgement has laid down several principles with respect to the reopening of cases as initiated by the tax officers. The fact that the taxpayer had adhered to all the compliances, documentation and disclosure worked in favour of the taxpayer. The HC in this case has upheld the validity of a TRC to claim benefits of tax treaties. This judgement of the HC was based on the Apex Court decision in case of Azadi Bachao Andolan[2] and Vodafone International BV[3] wherein a TRC was held to be sufficient evidence for determining the residential status.*

The decision of the High Court reaffirms the positions that TRC is the basic document to claim benefits under DTAA.

- **Hire Charges received under Time Charter agreement cannot be taxable as royalty if control over ship remains with the owner.**

  - Nan Lian Ship Management LLC[4] vs. ACIT

The taxpayer in this case, was a tax resident of UAE, which was engaged in the business of shipping operations, had entered into an agreement with Poompuhar Shipping Corporation Limited ('PSCL') for transporting coal through ship. Taxpayer had offered the receipt from the agreed services to tax under section 44B of the Act which deals with taxation of non-resident shipping companies whereby the taxable income is 7.5% of gross receipts. However, the tax office held that the receipt by the taxpayer was for use/right to use for letting out of vessel and thus falls within the meaning of royalty under section 9(1)(vi) of the Act which would be subject to tax at 10% plus applicable surcharge plus 4% cess of the gross receipts. The taxpayer filed an appeal before the Tribunal against the order. The Tribunal made the following observations: -

a. The compensation is based on freight as per loading per voyage
b. The hire charges are liable to be reduced pro-rata if the load on the vessel leads to lesser loading capacity for the charterer
c. The taxpayer was responsible for the maintenance of the vessel, payment of salary and wages to the crew members and the possession, ownership and maintenance of the vessel was with the taxpayer and not with the charterer

The analysis of the agreement is more in line with the voyage's charter and not a time charter which is a fixed rent agreement. The Tribunal held that that hire charges are not independent of the loading capacity and therefore it is not a case of leasing out an

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[2] Union of India v. Azadi Bachao Andolan [2003] 263 ITR, 706/132.

[3] Vodafone International Holdings B.V. vs. Union of India and Anr., (2012) 6 SCC 613

[4] Nan Lian Ship Management LLC vs. ACIT (Int. Tax) – 3(3)(1) I.T.A. No. 1857/Mum/2022

equipment and use or right to use of equipment. The Tribunal has placed reliance on Mumbai Bench decision in case of Smit Singapore Pte Ltd[5] wherein under similar circumstances, the time charter receipts were held to be taxable under Section 44B of the Act and not as royalty. Therefore, the receipt is taxable under section 44B and not under section 9(1)(vi) of the Act.

***JMP Insights** –This is a case of specific vs general provisions of law where section 9(1)(vi) of the Act is a general section whereas section 44B of the Act specifically taxes non-resident foreign companies in the shipping industry.*

- **Agreement with words 'make available' alone is not a decisive factor for taxability as fees for technical services.**

  - TSYS Card Tech Limited[6] Vs. DCIT

The taxpayer had earned revenue from Indian Customer for:

(i) Rendition of software license (referred to as 'PRIME), and

(ii) Provision of software related services including implementation services, enhancement services, annual maintenance services and consultancy services.

The tax officer had considered receipt of software licence fee and receipts from provision of other related services as taxable as fees for technical services as per the Act read with India-UK DTAA. The Tribunal relying on software license agreement held that the user has no right to make copies or commercially exploit the right in the copyright of such software and following the ratio laid down by Hon'ble Supreme Court in Engineering Analysis Centre of Excellence Private Ltd[7] held that the receipts from providing software license was not taxable as royalty and in absence of PE in India, it is not taxable as business income. With regard to taxability provision of other related services which is intricately and inextricably associated with utilisation of software, the Tribunal held that "when software itself is not taxable, the training and the related activities concerned with utilization and installation cannot be held to be FTS." The Tribunal further held that simply latching on to use of words "Make Available" in the agreement, it cannot be said that conditions of Article 13(4)(c) are satisfied. Burden is on the taxpayer to demonstrate that make available condition is satisfied.

***JMP Insights** – The Tribunal has held that if the main source of income is not taxable, the source which is intricately and inextricably linked to the first source is also not taxable. There are plethora of judgments where tax authorities have taken a similar position of not taxing the provision of other related services which is intricately and inextricably associated with utilisation of software.*

[5] ITA No. 7055/Mum/2017
[6] ITA No. 2006/Del/2022
[7] Civil Appeal Nos. 8733-8734 of 2018

- **Property transfer without registered sale deed, no ground for denying Section 54F benefit.**

    - ACIT, Circle-69(1). New Delhi vs. Sanjay Choudhary[8]

    In this case, the taxpayer had received consideration from sale of a property which he had received on settlement with his brother. He declared the consideration in his return of income as income from capital gain and claimed deduction under section 54/54F of the Act of properties purchased from the sale consideration. The Principal Commissioner of Income Tax ('PCIT') had given directions under section 263 of Act to the tax officer to disallow the exemption of long-term capital gain ('LTCG') under section 54F of the Act as in the opinion of the PCIT, the gain was short term i.e., period of holding was less than 36 months. However, the tax officer carried out a fresh assessment concluding that the gain arose was long term capital gain and disallowed the deduction under section 54F of the Act. However, the taxpayer filed an appeal against the order before the higher authorities which was ruled in favour of the taxpayer. Aggrieved by the order of higher authorities, the tax officer filed an appeal to the Tribunal.

    The Tribunal held that the properties acquired otherwise than by a registered sale deed falls within the ambit of the word 'purchase' in section 54/54F of the Act. Non-registration of the sales documents only transfers legal ownership of the property this affects the rights of the buyer and seller of the property and has civil consequences. For section 54/54F of the Act the important question is whether the amount paid towards purchase is out of the LTCG for claiming exemption. The fact that the tax officer didn't dispute the payment towards the purchase of these properties which was from the consideration received from sale of other property by a POA and denying the benefit of exemption is not right in law. The dispute by the tax officer that the properties purchased are not residential properties is not right as correctly pointed out by Commissioner of Income Tax (Appeals). The nomenclature of the type of house like cottage, plot, and farmhouse is only indicative that the property is not a commercial property and constitute as residential property. Referring to a judgement passed by the Jaipur Tribunal in Om Prakash Gyal[9], that the condition to claim exemption under section 54F of the Act is construction of a residential house doesn't matter if it is on an agricultural land.

    ***JMP Insights** –Section 54/54F of the Act, only requires investment of capital gain into residential house property. Registration of the purchase agreement is a technicality having a bearing on the legal and civil rights of the buyer and seller, which does not affect the availability of exemption under the Act.*

[8] ACIT, Circle-69(1). New Delhi vs. Sanjay Choudhary, ITA No.1274/Del/2020, A.Y. 2013-14
[9] ACIT v. Om Prakash Gyal [2012] 24 taxmann.com67 (Jaipur Tribunal)

DID YOU KNOW?

Companies registered under the Companies Act, 2013 and maintaining their books of account in electronic form are required to use accounting software that has a feature of recording audit trail of every transaction and which creates a log for every change made by the user. The said amendment is effective from 1 April 2023.

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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