Tax Matters

Issue No. 2023/05 Date: 11 May 2023

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 April 2023:

Income tax rulings

- **Selection of comparables for determination of Arm's Length Price ('ALP') can be admitted as a "substantial question of law'' by High Court ('HC')**

  - SAP Labs India P. Ltd vs. Income Tax officer, Circle 6[1]

Under the Income Tax Act,1961 ('the Act'), an appeal against the order of Income Tax Appellate Tribunal ('the Tribunal) shall lie to the HC only if the HC is satisfied that the case involves a "substantial question of law".

On this aspect, the Karnataka HC, in the landmark case of Softbrands India Private Ltd[2] held that the Tribunal is the final fact finding authority and therefore, issues relating to appropriateness of comparable/selection of filters should not be reviewed by the HC. The HC specifically observed that mere difference of views by the Tribunal on comparables/selection of filters does not satisfy the requirement of "substantial question of law" to enable HC to admit the appeal.

In the case of the taxpayer, the Hon'ble Supreme Court ('SC') reversed the decision of the Karnataka HC and held that it is always open to the HC to admit an appeal involving the determination of ALP to examine whether the relevant transfer pricing provisions have been complied and whether the findings of the Tribunal are perverse or not. The HC can also examine the question of comparability of two companies or selection of filters and examine whether the same is done judiciously and on the basis of the relevant material/evidence on record.

JMP Insights *– The SC ruling will have far-reaching implications for taxpayers in India including a large number of cases covered by the HC rulings that relied on the Karnataka HC decision. This may potentially increase the time-frame to resolve transfer pricing disputes as well as adding to the significant backlog of cases.*

Going forward, the taxpayers may consider proactively strategizing in advance - whether they should focus on the domestic litigation route or evaluate alternate dispute resolution mechanisms such as Mutual Agreement Procedure and Advance Pricing Agreements.

[1] Civil Appeal No. 8463 OF 2022

[2] PCIT v. Softbrands India (P) Ltd. (2018) 406 ITR 513

- **Income tax refund cannot be withheld merely because case is selected for scrutiny assessment**

  - OYO Hotels and Homes Private Limited v Dy. Asst. Commissioner of Income Tax[3]

The taxpayer filed the return of income for Assessment Year 2020-21 declaring a loss and claiming income tax refund. Subsequently, the taxpayer had filed a revised return of income. Subsequently, the case of the taxpayer was selected for scrutiny under the faceless regime. In the interim, the taxpayer received an online intimation under section 143(1) of the Act determining an income tax refund based on primary assessment of the return of income.

However, regardless of receipt of the intimation granting refund, no disbursement of the income tax refund was made to the taxpayer on the basis of a letter received from the Faceless Assessment Unit by the Tax Department. However, the letter did not contain any enclosures or reasons for the withholding of the refund.

In a writ petition filed before the Delhi HC, the HC observed that the Tax Department had not followed the mandatory procedures and conditions as laid down under section 241A of the Act. The HC held that a refund cannot be withheld simply because the case of the taxpayer is selected for scrutiny assessment. Section 241A of the Act requires the Tax Department to record reasons for withholding the refund in writing, elaborate how the grant of the refund in their opinion is likely to adversely affect the revenue and obtain the approval from Principal Commissioner of Income Tax or Commissioner of Income Tax prior to issue of the order withholding the refund.

While delivering the aforesaid decision, the HC relied upon the jurisdictional precedents in the case of *Ingenico International*[4] and *Maple Logistics*[5].

***JMP Insights** – This judgement highlights the specified procedure to be followed by the Tax Department before withholding the income tax refund of a taxpayer. Mere issuance of notice for scrutiny assessment does not justify the withholding of refund. The Tax Department is mandatorily required to substantiate the reasons that would adversely affect the interest of revenue before withholding the refund.*

[3] [W.P. (C) 16698/2022]
[4] 2021 SCC OnLine Del 2969
[5] 2019 SCC OnLine Del 12366

- **Dividend Distribution Tax ('DDT') being a tax on distributed profits, not eligible for a beneficial rate as per the Double Taxation Avoidance Agreement ('DTAA'), unless specifically protected by DTAA**

  - DCIT, Mumbai vs. Total Oil India Pvt Ltd.[6]

The Special Bench of the Tribunal relied on the principle laid down by SC in case of Godrej & Boyce Mfg Co. Ltd[7] and the jurisdictional HC in case of Small Industries Development Bank of India[8] in concluding that DDT is neither a payment on behalf of the shareholder nor it is to be regarded as payment of liability of the shareholder, discharged by the domestic company distributing dividend.

The Tribunal held that DDT is not a tax on the income earned by the shareholders but a tax on the profits distributed by a domestic company. The non-obstante clause in section 115-O of the Act indicates that the charge under the said section is independent from the concept of 'total income' under the Act.

Further, the Tribunal analysed the scheme of the DTAAs and observed that DTAAs should be looked from the taxability perspective of the recipient of income and not for the domestic company distributing the dividend. Thus, the domestic company covered under section 115-O of the Act does not enter the domain of DTAA at all. If the domestic company has to enter the domain of the DTAA, the countries should have agreed specifically to that effect in the DTAA.

JMP Insights *– This is an important ruling wherein the Special Bench of the Tribunal has put to rest the ongoing controversy on the DDT issue.*

We want to highlight that the Finance Act 2020 eliminated DDT and the exemption under Section 10(34) of the Income-tax Act, 1961, shifting the responsibility of taxing dividends from the company to the ultimate shareholders. As a result, non-resident shareholders have the option to select the more favourable withholding rate under the Act or the relevant DTAA.

- **NR's Capital gains taxation for sale of unlisted shares under special provisions to prevail**

  - Legatum Ventures Limited v Asst. Comm. Of Income Tax[9]

The taxpayer, an UAE based company engaged in investment activities, sold shares of an unlisted Indian company and declared long term capital loss after giving effect to foreign exchange fluctuation benefit under first proviso to section 48 of the Act. Further, the taxpayer contended that if the computation under section 48 of the Act results in a

[6] TS-197-ITAT-2023(Mum)
[7] 394 ITR 449
[8] 133 taxmann.com 158
[9] ITA no.1627/Mum./2022

loss, there is no need to refer to section 112(1)(c)(iii) of the Act to determine the tax payable, in absence of any taxable income.

The tax officer disregarded the applicability of the first proviso to section 48 of the Act and proceeded to compute tax on capital gains in the hands of the taxpayer under Section 112 of the Act which specifically excludes first proviso to Section 48 of the Act. The tax officer relied on the SC judgement in the case of *Gold Coin Health Food Pvt Ltd*[10] and held that the term 'income' as specified in Section 112 also includes loss.

On the basis of the below observations, the Tribunal concluded that the Capital gains have to be computed only by reference to provisions of section 112(1)(c)(iii) of the Act –

i. Section 112(1)(c)(iii) of the Act is a special provision for computation of capital gains arising from the transfer of unlisted shares and securities for non-residents. On the other hand, section 48 of the Act is a general provision that deals with the mode of computation of capital gains in all cases of transfer of capital assets.
ii. It is a well-settled rule of interpretation that if a special provision is made with respect to a certain matter, such matter is excluded from the general provisions under the rule which is expressed by the maxim 'generalia specialibus non derogant.
iii. It is also a well-settled rule of construction that when, in an enactment, two provisions exist, which cannot be reconciled with each other, they should be so interpreted that, if possible, effect should be given to both provisions.

JMP Insights *– The Tribunal ruling has added to the complexities involved in the computation of Capital gains, especially in the hands of non-resident taxpayers. This ruling would lead to higher Capital gains tax even when the non-residents have not made any gains in forex terms.*

Following the judgement, the non-residents will have to evaluate their investment positions which could also have an impact on the country's FDI inflows.

It is likely that the Tribunal order will be appealed in the High Court.

A detailed article on this subject along with a practical case study has been published by JMP Advisors on a leading professional research portal – Taxsutra. The article can be accessed at the home page of JMP Advisors website.

DID YOU KNOW?

According to the notification released by the Central Board of Direct Taxes ('CBDT'), the Cost Inflation Index for the FY 2023-24 is 348.

[10] [2008] 304 ITR 308 (SC)

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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