Tax Matters

Issue No. 2023/08 Date: 13 September 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 August 2023:

Income tax rulings

- **Reassessment proceedings cannot be initiated on a non-existent entity**

  - Anokhi Realty Private Limited vs. Income Tax Officer Ward 1(1)(3)[1]

A Scheme of Amalgamation between a transferor company and the taxpayer was approved on 13 November 2019, effective from 1 April 2019. The transferor company informed its jurisdictional tax officer vide a letter dated 7 August 2019 and 30 January 2020 that it is in the process of getting amalgamated with the taxpayer.

In March 2021, the transferor company, however, received notice under section 148 of the Income-tax Act, 1961 ('the Act') for the reassessment of its income for the FY 2013-14 to 2016-17. In response to the notice, the transferor company stated that since it had amalgamated with the taxpayer with effect from 1 April 2019, a notice was issued on the non-existent company and therefore the reassessment proceedings be quashed. However, the tax officer completed the reassessment of income and passed the order on to the transferor company only.

The Gujarat HC placed reliance on the decision of SC in the case of *Maruti Suzuki India Limited*[2]. In that case, a Scheme of Amalgamation was approved in January 2013 and was effective from 1 April 2012. The tax officer was intimated about the amalgamation in April 2013. The SC observed that even though the tax officer was informed of the transferor company's non-existence, a notice was issued in its name. The basis on which jurisdiction was invoked was fundamentally at odds with the legal principle that the amalgamating entity ceased to exist upon the approved Scheme of Amalgamation. Participation in the proceedings by the taxpayer in the circumstances cannot operate as an estoppel against the law. The SC held that the assessment cannot be made on a non-existent entity as this was a substantive illegality and not a procedural violation of the nature adverted to in Section 292B of the Act.

Further, the HC distinguished the facts of the case from the decision of SC in the case of *Mahagun Realtors (P.) Ltd*[3], where the SC however had held that an assessment order cannot be quashed solely on the ground that it is passed in the name of the amalgamating entity, which ceased to exist post the effective date mentioned in the scheme of amalgamation. The facts of this case were that the transferor company amalgamated with the transferee company by the order of the HC dated 11 May 2007, effective April 1, 2006.

---

[1] R/Special Civil Application No. 17613 of 2021 (Gujarat HC)
[2] [2019] 107 taxmann.com 375
[3] [2022] 137 taxmann.com 91

On 28 August 2007 search and seizure operations were carried out on the transferor and the transferee companies, wherein the directors of both companies made a combined statement including on the name of the transferor company and the fact that the transferor company had amalgamated was not disclosed. Pursuant to such operations, a notice was issued to the transferor company on 2 March 2009 to file its Return of Income ('ROI') for the FY 2005-06. In response, the taxpayer filed its ROI on 28 May 2010 disclosing its PAN and date of incorporation. Importantly, in the details of business reorganisation, the ITR did not provide details of the amalgamation. The tax officer made several additions and passed an assessment order dated 11 August 2011 with the taxpayer being mentioned as the 'transferor represented by the transferee'.

The taxpayer had intimated the amalgamation to the tax officer by letter dated 22 July 2010 for FY 2005-06 but not for FY 2004-05. The proceedings for FY 2005-06 and 2006-07 were quashed as the amalgamation was disclosed. A return was filed, pursuant to notice, which suppressed the fact of amalgamation. Even though the transferor company had lost its legal existence, appeals were filed in the name of the transferor company. Even the affidavit before the Court was filed on behalf of the director of the non-existent transferor company. The HC held that the facts of the *Maruti Suzuki case* were distinguishable from the Mahagun Realty's case, as in that case the tax authorities were duly informed about the merger and change in name of the company, and yet the tax officer passed the assessment order in the name of the transferor company. In *Mahagun Realtors (P.) Ltd's* case the tax authorities were not informed about the amalgamation.

The Gujarat HC, in this case, relied upon the rationale of the decision in the case of *Maruti Suzuki* and distinguished the ruling of *Mahagun Realtors (P.) Ltd* as the latter was based on peculiar facts of that case. The Gujarat HC held that reassessment proceedings cannot be initiated on a non-existent entity when the taxpayer has intimated the fact of amalgamation to the tax officer.

JMP Insights *– This judgment upholds the principle that upon amalgamation the transferor company ceases to exist. If the tax officer is informed about such amalgamation, any assessment or reassessment can be made on only the transferee company. If the tax officer is not intimated about amalgamation, then the rationale of the SC's decision of Mahagun Realtors may apply and the assessment on a non-existent entity may also be held valid.*

Though the requirement of intimation of amalgamation to the tax authorities is not stipulated under the Act, it is in the interest of the taxpayer to disclose such facts to the tax officer.

- **Disposal of equity shares that arose from conversion of CCPS issued prior to 1 April 2017 allowed grandfathering benefit**

  - Sarva Capital LLC v ACIT, Circle 3(1)(2)[4]

In FY 2018-19, the taxpayer, a tax resident of Mauritius, earned long term capital gains from the sale of equity shares of two Indian companies, which it claimed in its ROI as exempt from taxation as per Article 13(4) of the India-Mauritius tax treaty ('DTAA'). Subsequently, the taxpayer filed a revised ROI wherein long-term capital gains earned from sale of equity shares of one of the companies, Veritas Finance Pvt Ltd, was offered to tax under Article 13(3A) of the DTAA.

The tax officer declined to grant the DTAA benefits to the taxpayer. One of the contentions was that since the taxpayer was not *liable to tax* in Mauritius, it cannot be treated as a tax resident of Mauritius in terms of Article 4(2) of the DTAA. The DRP upheld the order of the tax officer and the taxpayer filed an appeal before the Delhi Tribunal.

Before the Tribunal, the taxpayer raised an additional ground on the taxability of long-term gains on equity shares of Veritas Finance Pvt Ltd under Article 13(4) of the Tax Treaty. Since a fresh investigation of facts was not required, the same was admitted as an additional ground by the Delhi Tribunal.

The Tribunal delivered the judgment on two issues,

- Whether the taxpayer will be treated as a tax resident of Mauritius and;
- Whether the taxpayer is eligible to claim the beneficial provisions as laid down in Article 13(4) of the DTAA.

The Tribunal held that the tax officer cannot go behind the TRC to question the tax residency of the entity. It is a well-settled law that a TRC is sufficient evidence to prove residency of the taxpayer. The Tribunal placed reliance on the CBDT Circular No 789 dated 13 April 2000 as well as SC ruling in the case of Azadi Bachao Andolan[5] and HC decision in the case of Blackstone Capital Partners[6]. The Tribunal further relied on the SC ruling of Azadi Bachao Andolan wherein the SC interpreted the phrase *'liable to taxation'* as used in Article 4(1) of the DTAA. The SC held that merely because tax exemption has been granted under the domestic tax laws of Mauritius on income earned on capital gains, it cannot lead to a conclusion that entities availing such exemption are not liable to tax. On the basis of the ratio of the aforesaid decision, the Tribunal ruled in favour of the taxpayer.

On the second issue, the Tribunal observed that the taxpayer had acquired Compulsory Convertible Preference Shares ('CCPS') of Veritas Finance Pvt Ltd on 18 March 2016, which were converted into equity shares on 4 August 2017. The Tribunal held that the word used in Article 13(3A) of the DTAA is *"alienation of shares".* The word 'shares' is used in a broader sense and will include all shares including CCPS.

---

[4] ITA No 2289/Del/2022 (Delhi ITAT)
[5] 132 Taxman 373 (SC)
[6] 146 Taxmann.com 569 (Del)

Tribunal observed that conversion of preference shares into equity shares only resulted in a qualitative change in the nature of rights of the shares, there are no other material differences between CCPS and the equity shares. Therefore, the Tribunal held that CCPS acquired by the taxpayer before 1 April 2017 would get covered under Article 13(4) of the DTAA, and hence, would be exempt from taxation in India. Though the taxpayer offered the gains to tax in its revised ROI, it will not preclude the taxpayer from claiming benefit under Article 13(4) of the DTAA.

JMP Insights – *In the past, according to the DTAA, if a resident of Mauritius transferred shares of a company that was a resident of India, they were exempt from capital gains tax in India. However, this changed in 2016 with an amendment to the India Mauritius treaty. Now, gains from the transfer of shares of an Indian company acquired on or after 1 April 2017 may be taxable in India. However, gains from shares acquired before 1 April 2017 are grandfathered and continue to enjoy the tax exemption.*

In this decision, the Tribunal had to decide on the taxability of gains from the transfer of equity shares (after 1 April 2017) which were converted from CCPS that were acquired before 1 April 2017.

The Tribunal concluded that the term 'shares' should be interpreted broadly, including preference shares as well.

The ratio of this decision may be applied in case of merger of entities also. For instance, in case of a typical merger of Company A (having shareholders who are resident of Mauritius) into Company B, the issue of shares of Company B to the shareholders of Company A, is exempt under Section 47(vii) of the Act. In a case where the shares of Company A are acquired before 1 April 2017 and the merger is effective post 1 April 2017, the shareholder may take a view that capital gains earned on the sale of shares of the Company B could be exempt under Article 13(4) of the DTAA.

The Tribunal decided that the date of issue of CCPS should be considered the date of acquisition. However, some may argue that the date of conversion should be considered as the date of acquisition of equity shares. It is possible that the above decision will be challenged by the department in the High Court.

- **SC: Explains 'mutuality' principle qua Clubs' FD interest income; Bangalore Club ratio binding precedent**

  - Secunderabad Club Etc.[7]

The Supreme Court ('SC') in the judgement elaborated the Principle of Mutuality ('PM'). In general parlance, PM refers to the members working together for their common good. If there is surplus in the club, it is not seen as income but rather as a way to prepare for unexpected expenses.

[7] CIVL APPEAL NO(S). 5195-5201 OF 2012 (SC)

Issue for consideration

The question for determination before the SC was whether the deposit of surplus funds by the clubs as bank deposits is liable to be taxed in the hands of the clubs or whether the principle of mutuality would apply, and the interest earned from the Bank deposits would not be subject to tax under the Act.

The Taxpayer contended that its case should be decided basis the Cawnpore Club's[8] decision wherein it was held that interest from bank deposits earned by a club was not taxable due to the PM. The taxpayer invoked the doctrine of merger and contended that the said decision should be a binding precedent in its case. However, the SC observed that in the Cawnpore Club's decision, only the income from rooms let out to its members was not subject to tax. The appeals were disposed of without going into the larger question as to whether Cawnpore Club could be taxed on the interest income earned on the fixed deposits made by it in the banks, or whether the PM would apply to the said income.

The SC in this case held that a decision is binding not because of its conclusion, but because of the specific principle or reason (ratio decidendi) behind that conclusion. It was held that the surplus which is used for any purpose other than for the furtherance of the club i.e., for investments as deposits with banks will break the chain of PM. The principle will hold good, whether or not the bank with whom deposit is made, is a member of the club. Accordingly, interest on the bank deposits held with member banks is chargeable to tax and the benefit of PM is not available.

The principles that emanate from this decision can be summed up as under:

1. **Complete Identity** refers to everyone who puts money into the club is also a member who benefits from the club. There should be no outsiders involved.
   i. PM would not apply to interest income earned on fixed deposits made by Clubs in the banks irrespective whether the banks are corporate members of the club or not.
   ii. PM only applies until the club's money is deposited in banks. After that it is exposed to transactions with third parties which breaks the chain of mutuality. This would imply that the identity between contributors and participators is lost.
   iii. The relationship would then be like any other commercial relationship such as that between a customer and a bank where the fixed deposit is made by the customer for the purpose of earning an interest income. Hence interest income becomes taxable.
   iv. When a club extends facilities to non-members, the element of PM is lacking. For example, if a club opens its facilities to people who aren't members, it can be taxed on the profits it makes from those outsiders.

2. **Action in furtherance of the mandate of the club or association:** The actions of the participants and contributors must be in furtherance of the mandate of the club or association.
   i. In the case of a club, it would be necessary to show that steps are taken in furtherance of activities that benefit the club, and in turn its members.
   ii. The club's mandate can be determined from documents like rules, membership guidelines etc. However, it's important to consider both immediate and long-term benefits to the club and its members.

[8] (2004) 140 Taxman 378 (SC).

3. **No Personal Profits**: The people who contribute money to a fund (like members of a club) should not be able to make a profit from that fund. The money should either be spent for their benefit or given back to them.
   i. When a company or club makes a profit by doing business with its own members (who are also shareholders), that profit belongs to the members as shareholders, not as customers.
   ii. This does not count as a profit under the PM because the money essentially just goes from one pocket to another.
   iii. Even if there is a separate legal entity (like a company or club) which makes profit it will not be considered as a profit.
   iv. This is because there is no real profit involved; the money is collected from the members and given back to them, not as shareholders but as the people who paid it.

JMP Insight - *This SC decision brings clarity to the 'Principle of Mutuality' ('PM'). The PM is a legal idea that applies to clubs or associations where members pool their money for their collective benefit and not for making personal profits from club's money. Members and contributors should be the same people.*

Income Tax Notifications

➢ **Amendment in rules for perquisite valuation for rent-free accommodation provided by the employer**

The Central Board of Direct Tax ('CBDT') has issued Notification No 65/2023 dated 18 August 2023, making significant changes in the Income Tax Rules, 1962 ('The Rules') relating to the valuation of perquisite for concessional/rent free accommodation provided by the employer.

The following changes have been made to the valuation rules for unfurnished accommodation:

(i) Where accommodation is owned by the employer, the change in perquisite valuation is as follows:

Previous Categorisation and Rates		New Categorisation and Rates	
Population of cities	**Perquisite Amount**	**Population of cities**	**Perquisite Amount**
> 25 lakhs	15% of Salary[9]	> 40 lakhs	10% of Salary
10 Lakh – 25 lakhs	10% of Salary	15 lakh - 40 lakh	7.5% of Salary
< 10 lakhs	7.5% of Salary	< 15 lakhs	5% of Salary

[9] Salary has been defined to include basic salary plus dearness allowance considered in the computation of superannuation benefits.

(ii) Where the accommodation is taken on lease/hire by employer, the change in perquisite valuation is as follows:

Previous Rules	New Rules
Lower of: - (i) Actual amount of lease rentals payable (ii) 15% of salary	Lower of: - (i) Actual amount of lease rentals payable (ii) 10% of salary

Further, CBDT has introduced a maximum cap on the amount of perquisite value for both owned and leased accommodation. The maximum amount of benefit should not exceed

$$\text{Amount of perquisite calculated for the first FY in which accommodation is provided} \times \frac{\text{Cost of Inflation Index (CII) of the FY for which the amount is being determined}}{\text{CII of the FY in which the employee first provided the accommodation}}$$

The Notification has further clarified that 'first year' would refer to FY 2023-24 or year in which accommodation was provided, whichever is later.

No changes have been made in the valuation rules for Government employer as well as for providing furnished accommodation.

The above notification will come into effect from 1 September 2023.

➢ Rule 11UACA for computing Sec.56(2)(xiii) income

The Finance Act of 2023 has introduced a new clause (xiii) in Section 56(2) whereby the scope of other income is proposed to be expanded to include any sum received on maturity of the life insurance policies, which are not specifically exempt.

The Central Board of Direct Taxes (CBDT) has issued Rule 11UACA to provide clarity and guidance on the computation of income from such policies:

1. **First-time receipt:** If a taxpayer receives a sum from such a life insurance policy for the first time, the taxable income comprises the received amount, including bonuses, less the aggregate of premiums paid throughout the policy term up to the receipt date.

2. **Subsequent Receipts:** If a taxpayer has previously received sums from the same policy, the taxable income is the received amount for the current financial year, less the premiums paid during the policy term until the receipt date. However, premiums considered in previous years' income calculations will not be considered again.

It's important to note that if premium deductions were previously claimed under any other provisions of the Act, these amounts will not be factored into the income calculation. In other words, no double deduction will be allowed.

***JMP Insights** – The introduction of this Rule seeks to ensure a consistent approach to taxing sums received from specific life insurance policies that lack Section 10(10D) exemption.*

DID YOU KNOW?

The Central Government vide Notification dated 4 September 2023 has amended Rule 9 of the Prevention of Money-Laundering (Maintenance of Records) Rules, 2005 whereby in case the client is a partnership firm, any natural person(s) entitled to more than 10% of capital or profits of partnership firm or who exercises control through other means shall be treated as 'Beneficial Owner'. The earlier threshold was 15% of capital or profits.

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 at coe@jmpadvisors.in.

JMP Advisors Private Limited

12, Jolly Maker Chambers II, Nariman Point, Mumbai 400 021, India
T: +91 22 22041666, E: info@jmpadvisors.in, W: www.jmpadvisors.com

About JMP Advisors

JMP Advisors is a leading professional services firm that offers advisory, tax and regulatory services. The vision of JMP Advisors is to be 'The Most Admired Professional Services Firm in India'. It aims to be the best as measured by the quality of its people and service to clients. The firm has a merit-based culture and operates to the highest standards of professionalism, ethics, and integrity. Jairaj (Jai) Purandare, the Founder Chairman has over four decades of experience in tax and business advisory matters and is an authority on tax and regulation in India. Jai was Regional Managing Partner, Chairman-Tax and Country Leader-Markets & Industries of PricewaterhouseCoopers India. Earlier, Jai was Chairman of Ernst & Young India and Country Head of the Tax & Business Advisory practice of Andersen India.

JMP Advisors offers advice in international taxation, domestic taxation, transfer pricing, mergers and acquisitions, Goods and Services Tax (GST), business laws and exchange control regulations and foreign investment consulting. We specialize in fiscal strategy and policy foresight and are also trusted advisors to high net worth families. Our team at JMP Advisors takes pride in being the best at what matters most to clients-technical expertise, innovative solutions, consistent, high quality service, reliability, and ease of doing business.

JMP Advisors has been recognized as a leading Tax firm in India in the International Tax Review (Euromoney) World Tax Directory for all successive years since incorporation, including the World Tax and Transfer Pricing 2023 Directory.