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 the month of September 2020:

Key Highlights of the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020

The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Bill, 2020 received Presidential assent on 29 September 2020. The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 ('the Amendment Act 2020') seeks to replace some of the provisions introduced in the Finance Act, 2020 and the Taxation and Other Laws (Relaxation of Certain Provisions) Ordinance, 2020 ('the Ordinance').

- **Tax exemption for Category III Alternate Investment Funds ('AIFs') located in International Financial Services Centre ('IFSC')**

  - Exemption from income tax on certain categories of income in the hands of the Category III AIFs located in IFSC has been expanded further. However, exemption will be available only for income attributable to units of AIFs held by non-residents who do not have permanent establishment in India.

  - Tax on income received in respect of securities of Indian companies and long term capital gains on transfer of such securities has been reduced to 10%.

  - Alternate Minimum Tax provisions would not apply to such Category III AIFs.

  - Further, exemption from income tax has also been granted to unit holders in respect of income from such units held or on transfer of such units.

- **Dividend taxation in the hands of Foreign Portfolio Investors ('FPIs')**

  The surcharge on dividend income earned by FPIs (structured as Trusts, Association of Persons, Body of Individuals) has been restricted to 15%. This will significantly reduce the tax rate of dividend for FPIs.

  JMP Insights – *The relaxation in the taxability of Category III AIFs and restriction in the surcharge on dividend income in the hands of FPIs will boost investors' confidence and attract more foreign investment in the country.*

- **Faceless Assessments**

  - Taking the baton of digital drive further, the Faceless Assessment scheme has been formally brought into the statute by way of introduction of a new section, section 144B in the Income-tax Act, 1961 ('the Act'), which will be applicable from Financial Year ('FY') 2020-21 and onwards. This new section lays down the manner in which the faceless assessment will be carried out.

  - Apart from faceless assessments, the other amendments in the Act brought almost all the income tax department proceedings "Faceless" by introducing Faceless Reassessment and Revisions, Faceless Transfer Pricing, Faceless Appeal Effect Orders, Faceless Prosecutions and Compounding of Offences, Faceless Rectifications, Faceless Stay and Collection/Recovery of taxes etc.

  - The newly inserted section 144B of the Act provides an option to the taxpayer to file its objections before the Dispute Resolution Panel either against a Draft Assessment Order, Final Draft Assessment Order or Revised Draft Assessment Order.

    JMP Insights – *In order to make the faceless assessment and other interaction with the tax authorities a success, both the taxpayers as well as the tax authorities need to adapt with the new era of virtual proceedings. Some of the pre-cursers on the part of the taxpayers would be to ensure updating contact details on the income tax portal, timely tracking and compliance through electronic mode, maintaining robust documentary evidence and clear articulation of facts for each submission before the tax authorities in the absence of physical hearings.*

- **Amendments to residency rules for Indian citizens/Persons of Indian Origin**

  - One of the conditions to trigger residency in India was that an individual should be present in India for at least 60 days in the relevant financial year and 365 days in past four years. In case of an individual being a citizen of India or Person of Indian Origin ('PIO') who, being outside India, comes on a visit to India, the threshold is 182 days.

  - Finance Act, 2020 reduced this period of stay in India from 182 days to 120 days for an Indian citizen or a PIO having India sourced income exceeding INR 1.5 million (~USD 0.02 million). However, it was not clear whether such an individual need to be based outside India and comes on a visit to India to trigger this rule.

  - It has now been clarified that the new rule will apply to an Indian citizen or PIO who, being outside India, comes on a visit to India.

- **New registration process applicable to charitable entities and research institutions**

  - Finance Act 2020 had prescribed a new registration process wherein existing registered charitable entities and research institutions registered under various provisions of the Act to make an application under new registration regime for continuing their registration.

- The provisions governing new registration regime for charitable entities and research institutions registered under various provisions of the Act will now be effective from 1 April 2021 (instead of 1 October 2020) and the old regime of registration will continue till 31 March 2021.

- **Donation to PM Cares Fund eligible for deduction under section 80G of the Act**

Due to ongoing pandemic, the Hon'ble PM had asked to voluntarily contribute to a new fund 'PM cares Fund'. Donation to this fund will entitle the taxpayer 100% tax break. In this regard, section 80G of the Act is amended to include the reference of this fund which will entitle the taxpayer to claim 100% tax break.

JMP Insights – *Due to imposition of lockdown under the COVID-19 outbreak, physical interaction between the taxpayers and the tax authorities was brought to a standstill. Various deadlines prescribed under provisions of the Act, which were extended by the Ordinance dated 31 March 2020 and then later by CBDT notification number 35/2020 dated 24 June 2020, have now been extended by the Amendment Act, 2020. Consequently, statutory timeline for completion of assessments during FY 2020-21 i.e. for Assessment Year ('AY') 2018-19 & AY 2017-18 (for Transfer Pricing and belated return cases) now stand extended to 31 March 2021.*

Income tax rulings

- **Reverses ITAT's slump sale taxation under section 50B of the Act for business transfer under HC approved scheme**

  - Areva T & D India Ltd. v. CIT (Madras HC) (Tax Case Appeal no. 673 of 2018)

The Madras High Court ('HC') in this decision had dealt with two substantial questions of law i.e. whether an additional claim can be made before the appellate authorities where factual details were filed during the course of assessment proceedings and secondly, whether transfer of any business undertaking through HC approved scheme, where consideration was through shares, can be treated as slump sale under section 50B of the Act.

As regard the question of raising additional ground is concerned, HC has affirmed the settled issue that there is no estoppel in tax laws and the assessee has a right to raise a new claim before appellate authorities where any amount is not subject to tax under the Act.

On the second legal issue of charging capital gains tax on transfer of a business unit, HC has held that the word "sale" for the purpose of slump sale under Section 50B of the Act would mean transfer of ownership in exchange for a **price** paid or promised or part paid and part promised. HC has made reference to the word 'price' as defined under section 2(10) of the Sale of Goods Act, 1930 to mean **money consideration for the sale of goods**. Accordingly, it has held that if there is no monetary consideration paid on the business transfer, then it is not treated as a slump sale and hence not subject to capital gains tax. Further, the business transfer was pursuant to approval of a scheme or arrangement i.e.it is **not a contractual transfer**, but a statutorily approved transfer and cannot be brought within the definition of the word '**sale**'.

Thus, relying on the various Supreme Court ('SC') and HC decisions, it was concluded that present case pertained to slump exchange and not slump sale. Accordingly, it was held that the business transfer made under a HC approved scheme wherein there is no monetary consideration involved and is settled only through issue of equity shares, then such a transfer is not covered by the provisions of section 50B of the Act and would not be subject to capital gains tax.

A similar view has also been taken by the Bombay HC in the case of CIT v. Bharat Bijlee Ltd [(2014) 365 ITR 258 wherein it has upheld the decision of Mumbai Income Tax Appellate Tribunal ('ITAT') and reaffirmed the difference between a slump sale and slump exchange].

- **Grants indexation benefit on long term capital gains while computing book profit as per section 115JB of the Act**

  - Best Trading and Agencies Ltd. v. DCIT (Karnataka HC) (ITA no. 191 of 2011 & ITA no. 32 of 2012)

The Karnataka HC has reversed ITAT order by holding that the benefit of indexation on long term capital gains will be available while computing book profit under section 115JB of the Act. The HC gave the reference to section 115JB(5) of the Act, which mentions that while arriving at the book profit for the purpose of Minimum Alternate Tax ('MAT'), the application of other provisions of the Act are open, except if specifically barred by the section itself.

Under the normal provisions of the Act while computing tax on long term capital gains under section 112 of the Act, the benefit of indexation to cost of acquisition is available as per second proviso to section 48 of the Act. However, although in books of accounts indexed cost is not recorded and hence the HC granted indexation benefit on long term capital gains while computing book profits on the basis of section 115JB(5) of the Act.

While giving this judgement, the Karnataka HC has also taken a note of CBDT Circular no. 762 dated 11 February 1998 wherein it was stated that companies earning substantial book profits and paying dividends were not paying any tax and hence to curb this practice MAT was introduced. Relying upon the said circular and the decision of Karnataka HC in the case of MSR & Sons Investment Ltd (ITA No. 769/2000), the HC has in the given case held that the provisions of section 115JB of the Act are not applicable as the taxpayer did not declare any dividend.

JMP Insights – *Considering the legislative intent given in Circular No. 762 behind introducing the MAT provisions, the HC has concluded that the MAT provisions would not be applicable if the taxpayer company is not declaring any dividend for that year. Further, the HC has also taken a note of section 115J of the Act, which does not contain a provision analogous to sub-section (4) of section 115JA or (5) of section 115JB of the Act, and therefore, held that while computing book profits for the purpose of MAT as per section 115JB of the Act, the taxpayer company can apply all other provisions of the Act, except if specifically barred by section 115JB of the Act, itself. Recently, Bangalore ITAT has also taken a same view in the case of Karnataka State Industrial Infrastructure Development Corporation Ltd v. DCIT (ITA No. 1659 & 1660/Bang/2013).*

- **Quality testing services for imported fabrics held not to constitute fees for technical services and not subject to withholding of tax**

  - DIT (IT) & DCIT (IT) v. Jeans Knit Pvt Ltd. (Karnataka HC) (ITA no. 383 of 2012)

The Karnataka HC by following the ruling given by the Bangalore ITAT has held that payment made to non-resident entity in Hong Kong for inspecting the quality of imported material and confirming its resemblance with the quality of material predetermined by the taxpayer does not require any specialised technical skills on the part of the non-resident and will therefore not fall under the purview of Fees for Technical services subject to withholding of tax under section 195 of the Act.

The HC has perused the terms of the agreement, copies of invoice, purpose of remittance and other relevant documents and inferred that the non-resident was not involved in identification of the exporter or in selecting the material and negotiating the price and held that non-resident was not rendering any consultancy services.

While analysing the meaning of “consultancy services”, the HC has referred the definition under the Black’s law dictionary and confirmed that the non-resident was merely acting as a link between the resident taxpayer and another party, facilitating the transaction between them which does not fall in the definition of consultancy services.

JMP Insights – *The question whether inspection and testing services fall within the ambit of fees for technical services has always been a debatable issue. We understand that the distinguishing factor for determining the taxability of the payment is whether the service required specialised technical skills or are routine commercial services. In the given case, the non-resident was merely acting as the agent and there was no independent application of thoughts carried out by the non-resident. The non-resident is required to discharge its commitments as per the direction of the taxpayer and therefore it was decided that no managerial services as well as consultancy services are being rendered by non-resident to the taxpayer.*

- **Year-end provisions made on ad-hoc basis attract tax withholding**

  - Tata Sky Limited v. ACIT (Mumbai Tribunal) (ITA no. 3214/Mum/2014 & ITA no. 3215/Mum/2014)

Mumbai ITAT ruling in favour of the tax authorities has held that once the taxpayer has made certain ad-hoc year end provisions and claimed the expenses as deduction by debiting it in the profit and loss account, tax on such expenses is liable to be deducted, even if not credited to the respective parties account. The Tribunal has re-iterated the provision of chapter XVII-B of the Act which clearly specifies that tax is required to be deducted either at the time of payment or at the time of credit in the books of accounts (including credit in the suspense account) whichever is earlier.

The Tribunal has also held that reversal/payment of year end provisions in the subsequent financial year would not alter the legal position in so far as disallowance of expenses under section 40(a)(ia) of the Act for non-deduction of tax is concerned.

JMP Insights – *Whether tax is required to be withheld on year-end provisions is a subject matter of controversy. All the businesses which follow mercantile system of accounting are required to create year end provision of expenses to reflect a true and fair view of the financial statements. Considering the specific wordings under Chapter XVII-B of the Act and the fact that the taxpayer has claimed deduction of the said expenses in the computation of income, the tax authorities always take a stand that tax is required to be withheld on the year-end provisions. Whilst Karnataka HC in the case of Karnataka Power Transmission Corporation Limited v. DCIT (TDS) (ITA no. 750 & 758-759/2009) and Ahmedabad ITAT in the case of Hardik Jigishbhai Desai v. DCIT (ITA no. 1084/Ahd/2013) took the view in favour of the taxpayer. Bangalore Tribunal in the case of IBM India Ltd v. ITO (TDS) (ITA nos. 749 to 752/Bang/2012 & 1588 to 1591/Bang/2012) took the view in favour of the Revenue/against the taxpayer on similar issue.*

- **Use of 'rupee' in section 40A(3) of the Act does not debar its applicability to cash spent in foreign currency**

  - Ramlord Apparels v. ACIT (Mumbai Tribunal) (ITA no. 7349/Mum/2018)

The Mumbai ITAT held that the mention of the word ‘rupee’ in section 40A(3) of the Act cannot be interpreted in a limited or narrow sense to mean only cash expenditure incurred in rupee. The Tribunal elaborated that the provision has to be interpreted in a manner to mean cash expenditure equivalent to the specified limit provided in section 40A(3) of the Act in rupee terms. Therefore, irrespective of whether the expenditure was incurred in cash in rupees or in foreign currency, the provisions of section 40A(3) of the Act will be applicable if it exceeds the specified limit in rupee term.

JMP Insights – *On analysing this judgement, it appears that the Mumbai ITAT has taken a view that law needs to be interpreted in a broader sense and provisions of section 40A(3) of the Act cannot be interpreted in a purely literal sense. Further, we understand that a literal reading of the provision would let the provision suffer from the vice of discrimination* *and that would not be the intention of the legislature. Therefore, the Mumbai ITAT has correctly rejected the argument of the taxpayer and disallowed the expenditure incurred above the specified limit in cash in foreign currency.*

- **Renovation expenses on 'new house' amounts to construction; benefit under section 54 of the Act allowable**

  - Ms. Juveria Begum & Others v. ITO (Hyderabad ITAT) (ITA no. 2224/Hyd/18, 297/Hyd/19, 298/Hyd/19 & 340/Hyd/19)

The Hyderabad ITAT has allowed exemption under section 54F of the Act on renovation expenses incurred on the newly purchased property.

The ITAT has held that section 54F of the Act only mandates that the capital gains should be invested in a residential house within the stipulated time by way of purchase or construction. Renovation of the new residential house by the taxpayer according to his/her requirements would amount to construction and hence exemption under section 54F of the Act can be claimed provided the construction is completed within 3 years from the date of transfer of original asset.

- **Allows 10% tolerance limit as provided under section 50C of the Act while determining Fair Market Value for buyer as per section 56(2)(vii)(b) of the Act**

  - Sri Sandeep Patil v. ITO (Bangalore ITAT) (ITA no. 924/Bang/2019)

Section 50C of the Act requires the taxpayer to consider the stamp duty value of the property if it exceeds actual sale consideration while computing capital gains in the hands of the seller of the capital asset. Further, if the difference between the stamp duty value and the actual sale consideration, exceeds INR 50,000 (~USD 670) then the same is taxable in the hands of the buyer as per section 56(2)(vii)(b) of the Act.

Section 50C of the Act further provides that if the difference between the stamp duty value and the actual sale consideration is less than 5% (now 10% as amended in Finance Act, 2020), then that difference is to be ignored. However, similar wordings are not provided for in section 56(2)(vii)(b) of the Act.

In the given case, the ITAT held that the 5% (now 10% as amended in Finance Act, 2020) tolerance limit though inserted later in the statute as a proviso to section 50C of the Act, it needs to be applied retrospectively and also proviso to section 50C of the Act needs to be imported into section 56(2)(vii)(b) of the Act as the buyer cannot be put into a disadvantageous position as compared to the seller of the property.

Further, valuation is always a matter of estimation wherein some degree of difference is bound to occur in the actual sale consideration as compared to the stamp duty value/value as arrived by the departmental valuation officer. There could not be two different "fair market value" in respect of the very same capital asset, i.e. one in the hands of the seller and another in the hands of the buyer. The principles applied to determine the fair market value in the hands of the seller should equally be applicable in the hands of the buyer.

Thus, it was held that the difference if less than 5% (now 10% as amended in Finance Act, 2020) is to be ignored and hence the difference should not be taxed in the hands of the buyer.

JMP Insights – *A proviso is inserted in a section to carve out something which is otherwise covered by the section. Here, the intention behind inserting a proviso needs to be considered. A proviso which is inserted to remedy unintended consequences and to make the provision workable or clarify or address genuine hardships faced by the taxpayer, then it needs to be treated as retrospective in operation. Accordingly, in the given case, the ITAT has applied the proviso to section 50C of the Act to section 56(2)(vii)(b) of the Act and gave the benefit to the taxpayer.*

Decision of The Permanent Court of Arbitration, Hague (Vodafone Case)

- **Vodafone wins international arbitration case against India in USD $2 billion tax dispute case**

Telecom major Vodafone Group Plc won arbitration against India over retrospective tax demand of INR 150 billion (~USD $2 billion).

- In 2007, the tax authorities had issued a show-cause notice to Vodafone International Holdings B.V (‘VIHB’) for failure to withhold tax due to indirect transfer in the Hutchison-Vodafone deal and subsequently imposed a tax demand.

- The matter ultimately reached to the SC in 2012, which eventually resulted in the landmark and controversial decision in favour of VIHB. This verdict of the SC was then nullified by a series of drastic retrospective amendments that virtually dried up foreign direct investment in India. The tax authorities again invoked the retrospective amendment pertaining to indirect transfer provisions putting the liability back on Vodafone Group.

- In January 2014, Vodafone used the Bilateral Investment Treaties (‘BIT’) to challenge the demand. The two sides could not resolve the issue in negotiations that followed and in April 2014, Vodafone served an arbitration notice.

- The Permanent Court of Arbitration (‘PCA’) in The Hague ruled the conduct of the Indian tax authorities in breach of 'fair and equitable' treatment. The Court held that the Indian Government's imposition of tax liability on Vodafone by applying the retrospective amendment is in breach of the investment treaty agreement between India and the Netherlands.

- It is anticipated that the Indian authorities will soon decide on the further course of action.

Notifications and Circulars

- **Clarification on Tax to be Collected at Source (‘TCS’) on sale of goods (CBDT Circular No. 17/2020 dated 29 September 2020 and Press Release dated 30 September 2020)**

  In order to widen and deepen the tax net related to TCS, a new sub-section (1H) has been introduced under section 206C of the Act vide Finance Act, 2020. The obligation to collect tax applies only in case of sale of goods and does not apply to sale of services.

  The provisions are applicable from 1 October 2020. However, the threshold of sale of goods of INR 5 million (~USD 0.07 million) will be calculated with reference to the entire year i.e. 1 April 2020 to 31 March 2021.

  TCS obligation will be on the seller of the goods whose total sales, turnover or gross receipts from the business exceeds INR 100 million (~USD 1.33 million) during the preceding previous year and receives consideration for sale of goods of aggregate value exceeding INR 5 million (~ USD 0.07 million) in any financial year.

  Tax shall be collected at the rate of 0.1% (0.075% till 31 March 2021) of the sales consideration exceeding INR 5 million (~ USD 0.07 million). However, in cases where the buyer fails to provide PAN/Aadhar number, tax should be collected at 1%.

  Since TCS is applicable on receipt of sale of goods, no adjustment on account of sales return or discount or indirect taxes including GST is required to be made.

  JMP Insights – *The rate of TCS is not very significant and the thresholds are liberal. However, the additional compliance burden may affect the ease of doing business for the taxpayers.*

- **Faceless appeals (Notification nos. 76/2020 and 77/2020)**

  As a step further towards enabling Faceless Appeals, the Central Government has notified the Faceless Appeal Scheme, 2020 (‘the Scheme’) vide Notification no.76/2020 and 77/2020. The Scheme has come into effect from 25 September 2020. It is noteworthy that the Scheme shall apply to all pending appeals before Commissioner of Income Tax (Appeals) [‘CIT(A)’].

  The Scheme introduces several new concepts and new expressions which have been defined therein. Some of the key highlights of the Scheme are as follows:

  - The set-up of Faceless Appeal Centres would comprise of a National Faceless Appeal Centre (‘NFAC’), Regional Appeal Centres (‘RAC’) and Appeal Units (‘AU’). AU is the equivalent of the present set-up of a CIT(A). The common point of contact with respect to the information or documents or evidence or any other details shall be the NFAC. Any appeals against orders of NFAC will lie before the ITAT having jurisdiction over the jurisdictional tax officer.

- All the proceedings under Faceless Appeals would be conducted entirely through an electronic mode and all exchange of communication between the NFAC and the taxpayer as well as all internal communications between NFAC, RFAC, National e-Assessment Centre, tax officers and AU will be strictly through electronic mode. Specific circumstances will be prescribed where a personal hearing (through video conferencing mode) may be conducted.

JMP Insights – *While this is a welcome move, the set up and structure of the Scheme may appear to be complicated initially and the taxpayers may take some time to get comfortable with the functionality of the Scheme.*

Time taken for the back and forth flow of orders, etc. would be crucial and there should be a proposal to limit the time that may be taken at each step. Completeness and crispness of the written submissions along with the submission of all the required material and evidences virtually will become a challenge.

- **CBDT amends income-tax rules to make Indian branches of foreign insurers eligible to obtain certificate for interest or other sums received without tax deduction (Notification No. 75/2020/F. No. 370142/8/2020-TPL)**

CBDT has amended Rule 29B of the Income Tax Rules,1962 ('the Rules'), dealing with application for certificate under section 195(3) of the Act and has now authorised foreign insurers in addition to foreign banks to apply for a NIL withholding tax certificate under section 195 of the Act. The amendment has come into force from the date of its publication, i.e. 22 September 2020.

JMP Insights – *This has been one of the long standing demands of the insurance industry and JMP Advisors had recommended to the Government to extend this facility of making application for receiving interest or other sums without deduction of tax, to foreign insurance companies as well.*

The issuance of notification by the CBDT relaxing the conditions under Rule 29B of the Rules treating foreign insurers at par with Indian branches of foreign banks is a welcome step and is expected to provide a sigh of relief to all foreign insurance as well as reinsurance companies having a business in India.

DID YOU KNOW?

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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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About JMP Advisors

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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 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.

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