Tax Matters

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Team JMP Advisors is pleased to bring to you a gist of some of the significant developments in the tax and regulatory space during the month of August 2020:

Income tax rulings

➢ Reimbursement to AE for salary of seconded employees held not to constitute fees for technical services and not subject to withholding tax

- Boeing India Private Limited v. ACIT (Delhi Tribunal) (ITA No. 9765/Del/2019)

Relying on the judgment of the co-ordinate Bench in the case of AT&T Communications Services India Private Limited [IT Appeal Nos. 1653 (Delhi) of 2016 & 354 (Delhi) of 2017], the Delhi Tribunal has held that reimbursement of salary of expatriate employees to the Associated Enterprise ('AE') is not in the nature of Fees for Technical Services or Fees for Included Services under the Income-tax Act, 1961 ('the Act') as well as the Double Taxation Avoidance Agreement ('DTAA'). In arriving at this decision, the Tribunal observed that the expatriates were released by the AE and were totally under the management and control of the Indian entity, making it clear that they were the employees of the Indian entity. Further, tax was withheld by the Indian entity on their salary under section 192 of the Act. The AE was merely facilitating salary payments in the home country of the deputed employees on behalf of the Indian entity, which were reimbursed by Indian entity.

JMP Comments - Reimbursement of salary cost of seconded employees has long been a subject of controversy. The Tribunal has adopted a contrary view from that of the Delhi High Court adopted in the case of Centrica India Offshore India Limited (364 ITR 336), relied upon by the Revenue. The facts involved in the Centrica case were significantly different from the present case, since in Centrica, the deputed employees imparted their knowledge and skills to help set up the processes and practices for the newly formed Indian entity. Therefore, rightly, the decision of Delhi HC in Centrica India was distinct in nature and cannot be applied in all cases and the facts of each case should be studied separately.

➢ Set off and carry forward of long term capital loss on STT paid sale of equity shares denied since it falls under the head of exempt income

- Nikhil Sawhney v. ACIT (Delhi Tribunal) (ITA No. 1248/Del/2017)

The Delhi Tribunal has held that long term capital loss on sale of equity shares which was subject to Securities Transaction Tax ('STT'), cannot be allowed to be set-off or carried forward against other long term capital gain. In rendering its judgment, the Tribunal has held that income includes loss and when income is exempt under section 10(38) of the Act, both positive income and negative loss will not form part of the computation of income of the taxpayer.

The Tribunal has relied on the judgement of the Gujarat High Court in the case of Kishorebhai Bhikhabhai Virani (367 ITR 261) which has identical facts and which had followed the decision of the Supreme Court in the case of Hariprasad and Co. (99 ITR 118) There is a contradictory decision of the Mumbai Tribunal in the case of Raptakos Brett & Co. Ltd. (69 SOT 383) which has relied on the decision of the Calcutta High Court in the case of Royal Calcutta Turf Club (144 ITR 709). In the present case, the Tribunal rejected the taxpayer's argument that the decision of the Gujarat High Court should not be followed since it is 'sub silentio' or 'per incuriam', on the basis that a Tribunal, being subordinate to the High Court cannot hold that a decision of a High Court is 'sub silentio' or 'per incuriam'.

JMP Comments - The question of allowability of losses on sale of equity shares which have been subject to STT where the income, if any, would have been exempt under section 10(38) of the Act has been dealt with by various courts, resulting in contrary rulings and a long standing debate. The amendment to bring to tax long term capital gains which were earlier exempt under section 10(38) has spurred this debate further since this source of income is no longer exempt. On analysing this judgement, it appears that the Hon'ble Tribunal has taken a view that the law prevalent as on the date of incurrence of loss is to be considered rather than the law prevailing on the date of set off of such loss.

- **Upward adjustment to income on account of capital reserve arising on amalgamation deleted and contention of the transaction being sham rejected**

  - Hespera Realty Private Limited v. DCIT (Delhi ITAT) (ITA No. 764/Del/2020)

The Delhi Tribunal has rejected the addition made by the Revenue authorities to book profits by characterising capital reserve arising on account of amalgamation as revaluation reserve. The Tribunal also rejected the Revenue's contention that the scheme of amalgamation is a colourable device and an instrument to evade tax as well as that the purchase method of accounting was adopted merely to inflate the value of the investments and create a capital reserve.

The Tribunal further held that the Revenue had failed to appreciate that the revaluation reserve is created on revaluation of assets acquired in the past. However, in the given case, the investment has been newly acquired at fair value under an approved scheme of amalgamation.

Section 115JB refers to book profits which are computed in accordance with section 129 of the Companies Act by following Accounting Standards ('AS'). Accordingly, the scheme of amalgamation has been accounted for in accordance with AS 14 and an upward revaluation of long term investments is not permitted by AS 13. After examining the mentioned facts, ITAT ruled in favour of the taxpayer.

JMP Comments - A similar issue was addressed by the Hon'ble Supreme Court in the case of Apollo Tyres Ltd. 255 ITR 273 (SC) wherein it was held that the powers of the assessing officer are restricted to examining the books of account as certified under the Companies Act. The assessing officer does not have the authority to probe into the accounts prepared in accordance with Companies Act. Thus, an assessing officer is not

authorised to carry out adjustments beyond those provided under Explanation 1 to Section 115JB of the Act.

- **Shares held by nominees on behalf of holding company not to be a deterrent for the subsidiary in claiming exemption for capital gains under section 47(v) where a transfer by a wholly owned subsidiary to its holding company is envisaged**

  - CIT v. Shardlow India Limited (Madras HC) (Appeal No. 485 of 2018)

  The Madras High Court allowed the exemption under section 47(v) in the case of transfer of land by the taxpayer to its 99.99% holding company. The High Court held that if a purposive interpretation of the law should be adopted otherwise, section 47(v) will become redundant. The minority shares (25 in number) are held by nominees to comply with the provisions of the Companies Act and the individual shareholders have no individual right. Accordingly, it was held that the taxpayer is regarded as a wholly owned subsidiary for the purposes of section 47(v) of the Act and that the exemption under section 47(v) is rightly applied in the given situation.

- **Share of receipts from construction contract paid to JV Partner constitutes diversion of income by overriding title**

  - Peartree Enterprises Private Limited v. DCIT (Delhi Tribunal) (ITA No.4199/Del/2016)

  The Delhi Tribunal observed that as per the Joint Venture ('JV') agreement entered into by the taxpayer for a road construction project, both the parties to the JV were responsible for their respective share of services to the clients and were to individually assume the risks associated with their services. Neither party was entitled to the profit or loss arising from the other party's services. Further, on receiving the payment from the client, the taxpayer was entitled to 97% of the revenue and the balance 3% was to be paid to the JV partner. Therefore, the Tribunal held that the amount paid by the taxpayer to its JV partner is "diversion of income by overriding title" and not a payment of commission. Accordingly, there are no withholding tax obligations and hence, the question of disallowance under section 40(a)(ia) of the Act would not arise.

  JMP Comments – In this judgment, the Delhi Tribunal has rightly applied the settled principle that when income is paid to the beneficiaries from the source itself, it is a case of diversion of income by overriding title.

  Further, generally, in a JV situation, an issue arises as to whether the income of the JV should be taxed separately in the hands of the JV Partners or as the income of an Association of Persons ('AOP'). In rendering this ruling, the Delhi Tribunal has rightly applied the guidance laid down in the CBDT Circular No. 7 dated 7 March 2016 where it is provided that if each member of the JV is independently responsible for executing its part of work using its own resources, each member bears the risks associated with its scope of work and each member earns profits or losses based on the performance of its own scope of work, in that case, each member should be independently taxed in respect of its own income.

Income tax Circulars and Notifications

➢ Transparent taxation platform

The Prime Minister launched the Transparent taxation platform on 13 August 2020, emphasising on a tax system aimed at being Seamless, Painless and Faceless with three pillars as under:

- Faceless assessment
- Faceless appeals
- Taxpayers' Charter

Faceless assessment scheme

The Finance Act, 2018 had amended section 143 of the Act to incorporate enabling provisions for an assessment scheme to impart greater efficiency, transparency and accountability. Accordingly, an e-assessment scheme was notified in September 2019 to lay down the process and procedure for faceless assessments. Certain amendments were made in the process in August 2020 and the scheme was renamed as "Faceless Assessment Scheme, 2019".

The faceless assessment scheme would not cover cases of search, seizure and international tax matters, which will continue to be scrutinized by the jurisdictional Tax Officer. Further, it has been clarified in a webinar by the Revenue Authorities that Transfer Pricing matters would also not be covered in the faceless assessment scheme. Barring these, all scrutiny matters would now be undertaken through the faceless mode.

Guidelines have been notified in this regard, providing the structure and procedure of the faceless assessment scheme. It is proposed to have random selection of cases for scrutiny and work would be bifurcated between various units such as assessment unit, verification unit, technical unit and review unit. The proceedings would be conducted entirely through an electronic mode, including internal communication between various units of the Revenue authorities involved in the process. Specific circumstances will be prescribed where a personal hearing (through video conferencing mode) may be conducted.

JMP Comments - While this is a welcome move, targeted to significantly reduce personal interaction between the Revenue authorities and taxpayers, it needs to be seen whether this will also help to achieve the goal of reduction in tax litigation.

Faceless appeals

The Finance Act, 2020 introduced provisions for enabling faceless appeals in line with faceless assessments. Although the platform has been officially launched, the facility for faceless appeals will be available only from 25 September 2020. No notification or further clarifications have been issued on this aspect so far. However, it can be noted from the official website of the Income Tax Department that the scheme will involve random allotment of cases requiring electronic replies to notices and no personal visits will be required before the final order is issued by the Commissioner of Income-tax (Appeals).

Taxpayers' Charter

The Taxpayers' Charter which was announced by the Finance Minister in her Budget 2020 speech has been unveiled by the Prime Minister on 13 August 2020. The aim of introducing the charter is to build trust between taxpayers and the tax administration, to reduce harassment of taxpayers and honouring honest taxpayers.

Unlike earlier charters, which were largely administrative, this is the first one to have statutory backing. Section 119A was introduced in the Act which empowers the Central Board of Direct Taxes ('CBDT') to adopt and declare a taxpayers' charter and issue orders, instruction, directions or guidelines for administration of the charter. There are 14 commitments in the aggregate from the tax department including providing a fair and just system, holding the Revenue authorities accountable, reducing the cost of compliance, providing a mechanism to lodge complaints and treating the taxpayers as honest. Likewise, there are 6 expectations from the taxpayers such as being honest and compliant, paying taxes on time, responding on time and maintaining accurate records. Together, these commitments and expectations form the pillars of this charter. Although the detailed charter is not yet available, it would be interesting to monitor the manner in which it will be rolled out and evolve, as India seeks to establish a taxpayer friendly and stable regime.

➢ Guidelines on Mutual Agreement Procedure ('MAP')

The CBDT released a guidance on MAP on 7 August 2020 setting out in detail the process of MAP and providing guidelines on various issues under the broad headings of Basic information, Access and denial of access to MAP, technical issues and implementation of MAP. The said guidance also covers aspects of time frame for concluding a MAP application and roles and responsibilities of Competent Authorities ('CAs'). The key technical aspects dealt with in the guidance are summarized below:

- If a taxpayer applies Safe Harbour Rules in India and a MAP application is accepted by other territories, the Indian CA would not revise the Arm's Length Price ('ALP') of the international transaction covered under the Safe Harbour Rules. They would only request the treaty partners to provide a relief.

- Where MAP and domestic remedies like appeal to the Income Tax Appellate Tribunal ('ITAT') are sought simultaneously, the Indian CA shall not deviate from the orders of the ITAT.

  JMP Comments - Clarity is not provided on instances where the Revenue authorities file an appeal before the High Court after a MAP application has been concluded in favour of the taxpayer based on a favourable ruling given by the ITAT. It will be interesting to see whether the High Court would take cognizance of the MAP ruling or it would have the authority to deviate from the MAP ruling. Further, it is not clear that if the High Court renders a ruling against the taxpayer, whether the MAP application can be reinstated.

- A MAP application cannot be accepted for issues where a bilateral or multilateral Advance Pricing Agreement ('APA') application has been filed and accepted for the

same year. However, if the bilateral or multilateral APA application fails, a MAP application can be filed on the concerned issue for the same year.

- Where no Memorandum of Understanding has been entered into between India and a country for suspension of tax collection during the pendency of MAP proceedings, the Indian domestic tax law will govern the tax collection procedures.

- Where taxes have been paid as a result of an order passed under section 201 of the Act on an Indian entity (payer) for not withholding taxes on the payment made to a non-resident, it is clarified that such taxes would be permitted to be adjusted against the tax liability of the non-resident payee if the non-resident receives a favourable MAP outcome for the specific issue and for the relevant year.

- The CA of India would be obligated to make secondary adjustments in respect of cases for FY 2016-17 or thereafter if primary transfer pricing adjustments have been made.

The guidance has provided much awaited clarity on several issues regarding MAP.

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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