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 October 2020:

Income tax rulings

- **Implications under section 56(2)(viib) are triggered at the time of share allotment and not on receipt of share application money. The Assessing Officer ('AO') cannot ignore/reject the valuation methodology selected by the Taxpayer for determining the Fair Market Value ('FMV') of shares**

    - Taaq Music Pvt. Ltd. v. ITO (Bangalore ITAT) (ITA No.161/Bang/2020)

    Section 56(2)(viib) was introduced by the Finance Act, 2012 with effect from 1 April 2013. The Taxpayer had received the application money on 31 March 2012 and hence the amount received in addition to the face value of shares was not offered to tax as Other Income under section 56(2)(viib). The Bangalore Income tax Appellate Tribunal ('ITAT') observed that since the words used in the aforesaid section of the Income-tax Act, 1961 ('IT Act') are *'any consideration for issue of shares',* only on the allotment of shares the consideration received as share application money becomes a consideration for issue of shares. Since the date of issue of shares was 21 November 2012, provisions of section 56(2)(viib) were applicable.

    Relying on the judgement of the co-ordinate Bench in the case of Innoviti Payment Solutions Pvt. Ltd. v. ITO (102 Taxmann.com 59) (2019) and the Bombay High Court ('HC') judgement in the case of Vodafone M-Pesa Ltd. v. Pr.CIT (164 DTR 257) the Bangalore ITAT has held that the AO has the right to question the assumptions and scrutinize the data which form the basis of valuation. However, he cannot change the valuation methodology adopted by the Taxpayer. The Taxpayer could use the more beneficial method.

    JMP Insights – *The Bangalore ITAT has remanded the case back to the AO for revisiting the valuation done by the Taxpayer even though the AO during the primary scrutiny had an opportunity to review it.*

    It may be noted that the Kolkata ITAT in the case of Diach Chemicals and Pigments Pvt. Ltd. (citation) had taken a contrary view and held that for section 56(2)(viib) the date of receipt of share application money was to be considered as the date of issue of shares and not the date of allotment of shares. With due resepct to the Kolkatta ITAT's decision, considering the provisions of section 56(2)(viib) we are of the view that the decision taken by Bagalore ITAT is the correct view.

- **The beneficial rate of tax on dividend as per the Tax Treaty can be applied to the Dividend Distribution Tax ('DDT') rate**

  - Giesecke & Devrient (India) Pvt Ltd. v. ACIT (Delhi ITAT) (ITA No. 7075/DEL/2017)

The Delhi ITAT has reignited the doused fire on the debate of whether the rate of DDT under the domestic tax law can be restricted to the beneficial rate of tax under the Tax Treaty. It has held that the DDT is nothing but a tax on shareholders which was collected through the dividend-paying company, to avoid the administrative inconvenience of requiring the company to identify each shareholder and deduct tax at source. Accordingly, it was held that since ultimately DDT is a tax on shareholders and not on the company, the shareholders are entitled to apply the provisions of the Tax Treaty or the IT Act, whichever is more beneficial to them.

ITAT has traced the legislative history of taxation of dividends through Memorandum Explaining Finance Bills of 1997 and 2003 and has concluded that DDT was a product of administrative consideration over legal necessity. ITAT weighed in the economic aspect of DDT and has held "the burden of DDT falls on the shareholders rather than on the company, as the amount of distributed profits available for shareholders stands reduced to the extent of DDT levied."

ITAT has noted that the Germany Tax Treaty was notified in 1996 i.e. before the introduction of DDT provisions in 1997. The Germany DTAA restricts the tax on the dividend at 10% of the gross amount of dividends. ITAT has relied upon the Delhi HC ruling in New Skies Satellites (citation) and has held that the statutory amendment cannot override the treaty provisions and also it was ruled that reciprocal bargains as entered between the countries cannot be amended unilaterally. Relying upon the Supreme Court ('SC') ruling in Azadi Bachao Andolan, the Delhi ITAT has held that in case of inconsistency between the DTAA and the IT Act, the TAX TREATY shall prevail over the IT Act.

JMP Insights – *The Delhi ITAT has acknowledged that it was mindful of the fact that the Bombay HC, in the case of Godrej & Boyce Manufacturing Company Limited had unequivocally held that DDT was a tax on the company and not on the shareholders, although that case was in a different context. Even the SC had upheld the decision in favour of the Tax authorities.*

While the Tribunal was concerned with Germany Tax Treaty notified in 1996, the conclusion of the ITAT may also apply to other DTAAs entered even on a later date when the DDT regime was prevalent.

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- **Provisions of proviso to Section 32(1) cannot be invoked on the claim of depreciation made by the sccuessor company on the revalued intangibles of the partnership firm .**

  - Padmini Products Private Limited v. DCIT (Karnataka HC) (ITA no. 154 of 2014)

The Karnataka HC was faced with a question on allowing depreciation on intangible assets, which were previously revalued. The Taxpayer company was in the business of manufacturing incense sticks and had succeeded in the business of a partnership firm. Before the firm was converted to a private limited company, the partnership had revalued its intangible assets. All assets (including revalued intangibles) and liabilities of the firm were transferred to the company and the partners were allotted shares of the private company.

The assessing officer ('AO') denied depreciation on the intangibles as there was no actual consideration paid by the Company. The revenue arged that the value of the intangible assets was not a real/actual value for claiming depreciation under section 32(1)(ii) of the IT Act and that the present case is only a device to claim depreciation on notional assets. Further, it was argued that the depreciation is to be apportioned between the transferor and transferee as if the succession did not take place. The revenue also argued that transfer of the entire business of the firm to a company was taxable under section 45 of the IT Act. The genuineness and valuation aspects of this transaction were however not questioned by the AO.

The Taxpayer, on the other hand, argued that there is a transfer of real assets and liabilities between the firm and the company, making it eligible to claim depreciation. The transaction was covered by section 47(xiii) of the IT Act which does not consider the transfer of a capital asset by a firm to a company on account of succession as a transfer.

The HC observed that the firm was the registered owner of various trademarks of aroma on which the business of incense sticks is built. Such intangible assets had real value and were not fictitious assets. The tax authorities have not questioned the valuation technique or the genuineness of the transaction at any stage. Further, the HC observed that the intangible assets were transferred for a valuable consideration and therefore , the Taxpayer company is eligible to claim depreciation on these intangibles.

Further, the HC observed that all conditions of Section 47(xiii) are fulfilled and hence the transaction was not a taxable transfer. 5th proviso of section 32(1) was inserted by the Finance Act, 1996 to restrict the claim of depreciation by both predecessor and the successor. Since in the current case there is no such claim, it was observed by HC that the mentioned provision would not apply. Accordingly, the appeal was in the favour of the Taxpayer.

JMP Insights: *This type of tax planning is generally adopted for capturing the market value of intangible as well as tangible assets and bringing such market value of those assets in the books of account. However, one needs to be very careful about the valuation* *methodology adopted for bringing the market value of assets in the books of account, which is followed by certain resctircutring exercise.*

- **Allows TDS-credit to 'pass through' venture-capital Trust, though income taxable in contributors' hands**

  - ACIT v. Miles Stone Real Estate Fund (Mumbai ITAT) (ITA no. 1144/Mum/2018 & ITA no. 1145/Mum/2018)

Taxpayer, a venture capital trust , a pass-through entity had claimed exemption under section 10(23FB) for income from investments in the venture capital undertaking. It had also claimed credit for the TDS deducted on income from investments made by it. The AO was of the view that as per section 199 read with Rule 37BA, as the income was payable by the ultimate investors, the tax had to be deducted in their name and not in the name of the Taxpayer. So the AO had rejected the TDS credit claimed by the Taxpayer.

Mumbai ITAT has held that section 199 read with Rule 37BA will only be applicable where the Taxpayer provides complete details of the ultimate investors to the tax deductor. In this case, as details of the ultimate investors were not provided by the Taxpayer to the venture capital undertaking, the Taxpayer should be allowed credit for the tax deducted and reflected in Taxpayer's Form 26AS. It was further noted that the Taxpayer had furnished the details of income accrued/distributed to each of the ultimate investors as per Form 64 and also it was the responsibility of each of the ultimate investors to include the income in their tax returns. Since all the details of the ultimate investors were available with the AO it could be verified whether the ultimate investors had offered the income to tax. The Mumbai ITAT has upheld the CIT(A)'s order and relied on the decision of the Hon'ble Telangana and Andhra Pradesh HC in the case of IVRCL-KBL (JV) v. ACIT (citation) which stated that where there was no claim made by such other person the claim for credit cannot be rejected.

JMP Insights – *There are two appeals for the AYs 2013-14 and 2014-15. Though in this case the claim of TDS has been discussed, there is no mention of the fact under which section or provision of the IT Act the tax has been deducted.*

- **Indirect Transfer of Indian assets will not attract capital gains**

  - Augustus Capital Pte Ltd. v. DCIT (Delhi ITAT) (ITA no. 8084/DEL/2018)

In FY 2014-15, Taxpayer, a Singaporean company, engaged in the business of incubation of companies, transferred its entire shareholding in a Singaporean start-up that held investments in India, to an Indian company. The Taxpayer as per Explanation 5, 6 and 7 to section 9(1)(i) contended that the transaction involving the transfer of shares of a foreign company that held investments in India was not taxable in India.

As per the amendment to section 9 of the IT Act if any share or interest is derived from the transfer of share or interest in a foreign entity, which derives its value substantially from the assets located in India, then such income is deemed to arise in India. Explanation 5 to section 9(1)(i) of the Act which was introduced with retrospective effect from 1 April 1962 did not define the term 'substantially' and 'any share or interest in a company'.

Explanation 6, which was added by the Finance Act, 2016, clarified that word 'substantially' meant that the fair market value ('FMV') of assets located in India exceeded INR 10 crore and the FMV of the assets located in India represent at least 50% of the FMV of the total assets of the foreign entity. Explanation 7 exempted small investors holding less than 5% of the total voting power from implications of indirect transfer as per Explanation 5. Explanation 6 and 7 to section 9(1)(i) both were inserted with effect from 1 April 2016 and refer to Explanation 5.

The AO dismissed the claim of the Taxpayer stating that since Explanation 5 was given retrospective effect and Explanations 6 and 7 were inserted in furtherance of the object of Explanation 5, these two explanations cannot be read in isolation and need to be given a retrospective effect.

The Delhi ITAT has held that the capital gains were not taxable in India as the transfer of shares made offshore were not deriving substantial value from assets located in India on a co-joint reading of Explanations 6 and 7 read with Explanation 5 to section 9(1)(i) of the Act.

The Delhi ITAT relied upon the decision given by the Delhi HC in the case of Copal Market Research Ltd (49 Taxmann.com 125) where shares deriving less than 50% of its value from assets situated in India were held to be not taxable under section 9(1)(i) of the IT Act read with Explanation 5 thereof .

JMP Insights*:- This is a welcome decision for foreign funds and entities which are being subjected to tax demands for earlier years.*

The Delhi HC had given the decision in the case of Copal Market Research Ltd (Supra) when Explanation 6 and 7 were not inserted in the statute. On the recommendations made by the Shome Committee, the Finance Bill, 2015 amended the IT Act to include Explanation 6 & 7 to Section 9(1)(i). Thus, pre and post insertions of Explanation 6 & 7, the HC and ITAT were of the view that "substantially" mean at least 50% and transfer of shares deriving value less than 50% from the capital assets located in India should not be subject to tax in India.

➢ No Penalty Levied on short deduction of TDS on property purchase from a Non-Resident if the same was unintentional

- Shri Jitendra Sharma v. JCIT (Intl taxation) (Indore ITAT) (ITA no. 500/Ind/18)

The Taxpayer along with two other parties bought a property in India from a Non-Resident Individual. The property was purchased through a broker and the buyer and seller met for the first time only at the Sub-Registrar's office. The Taxpayer had deducted tax under section 194-IA @1% assuming the seller to be a Resident Indian. The Taxpayer was given a PAN copy of the seller, which did not mention the residential status. Since the sale deed, which mentioned the sellers both addresses, Indian and Foreign, the Taxpaper realised that there was a short deduction and therefore, he deposited the differential tax along with interest.

ITAT has remarked that merely having a local address in USA mentioned in the sale deed cannot be sufficient evidence that the person is an NRI. The Indore ITAT has deleted the penalty levied under section 271C, which was levied due to deduction of TDS under section 194-IA @1% instead of section 195 @ 20.6%. The ITAT has observed that on noticing that the seller is an NRI, the Taxpayers, as law-abiding citizens immediately deposited the correct amount of TDS along with interest. The ITAT has stated that the ‘bonafide conduct’ of the Taxpayer is a 'reasonable cause' for deletion of penalty.

JMP Insights*: - There are many cases where the buyers are not aware of the residential status of the seller, which may result in short deduction of tax at source under section 195.This is a welcome decision for the Taxpayers who make a genuine mistake in deduction of tax at source.*

In this case, though the buyer has deducted tax @ 20.6% as per the provisions of section 195 r.w.s. 112 of the IT Act, there is no discussion of the amount on which tax needs to be deducted under section 195 i.e. capital gains. In such cases, a seller may also apply for a certificate of deduction of tax at a lower rate from the tax department or obtain a certificate from a chartered accountant as well.

- **Beneficial rate as per Tax Treaty or IT Act applies separately to each royalty agreement**

  - DDIT & DIT v. M/s. IBM World Trade Corp (Karnataka HC) (ITA no. 278 of 2012)

Karnataka HC has upheld the ITAT’s order that the Taxpayer is entitled to claim the beneficial rate of taxes as per section 90 under the IT Act and the Tax Treaty year on year basis under a different agreement. IBM World Trade Corporation is a foreign company incorporated in US. As per section 115A(1)(b), the Taxpayer bifurcated the income based on the date of the agreement and applied beneficial rate as per Tax Treaty of [15%] in respect of income from the agreement entered before 1 June 2005 and a tax rate of 10% under section 115A of the IT Act w.r.t royalty income received in pursuance of the agreement entered into on or after 1st June 2005. The AO rejected such bifurcation and concluded the assessment at the flat tax rate of 15%. The CIT(A) upheld the AO’s order. The ITAT had ruled in favour of Taxpayer and held that as per section 90(2), the Taxpayer was justified in computing the tax at a rate beneficial to it.

The HC observed that the sub-clauses of section 115A(1)(b) are mutually exclusive and independent of each other. A foreign company has to compute tax on its income under each of the above sub-clauses separately and thereafter aggregate it as per section 115A(1)(b). HC noted that the contracts/agreements had been entered into on different dates. The statute recognizes such differentiation and provides for separate tax rates for each stream. HC has ruled that the expression 'to the extent' used in section 90(2) makes it evident that the Taxpayer can apply the rate of tax as per the IT Act or Tax Treaty, whichever is beneficial.

Notifications and Circulars

- **Leave travel Concession (LTC) Cash voucher Scheme for non- Central Government employees:**

Leave Travel Concession ('LTC') Cash Voucher Scheme ('Scheme') has been announced to the Central Government employees by the Finance Minister ('FM') on 12 October 2020 as one of the measures to boost the demand in the adversely affected economy due to the COVID-19 pandemic. On 29 October 2020 it was announced that the above scheme has been extended to non-Central Government employees also.

A Central Government employee claiming LTC is not eligible unless he actually travels; if he fails to travel the amount is deducted from his pay and he may be liable for disciplinary action. He does not have the option of keeping the money and paying income tax. Under the government system, the employee had only two choices: Either travel and spend (and the incidentals like hotel, food, etc. are to be incurred by him) or forgo the entitlement if not claimed within the date. Now a third option of "spend on something other than travel" has been given.

Currently, salaried employees are entitled to exemption on LTC or leave travel allowance ('LTA') under section 10(5) of the IT Act for the expenditure incurred for travel within India, subject to conditions. One of the conditions is that the exemption is available for 2 journeys in a block of 4 calendar years (current block being 2018-21). Taxpayers are entitled to exemption for airfare/railway fare for self and their family members as per the prescribed limits. The exemption is available for both government and private sector employees.

The travel restrictions imposed in the country due to COVID-19 pandemic, have made it difficult for the employees to avail this concession in the current block of 2018-21.

With a view to compensate employees and to provide a boost to consumption expenditure, the Government of India has allowed an exemption from amount of LTC paid by the employer equivalent to LTC fare, subject to conditions. The conditions are as follows:

- Buy goods/services worth three times the fare and avail one-time leave encashment on or before 31 March 2021.
- The money must be spent on goods attracting Goods and Service Tax (GST) of 12% or more from a GST-registered vendor.
- The payment must be made through digital mode and employee must produce GST invoice.
- If an employee spends less than three times of the deemed LTC fare, the deemed LTC will be reduced proportionately.

JMP Insights*: - As the benefit of LTC stimulus announced to the Central Government employees has now been extended to non-Central Government employees, there is a* *confusion amongst everyone whether the above LTC stimulus and its benefits can also be extended to private sector employees. Considering the statement issued on 13 October 2020 by the Ministry of Finance on misinterpretation of LTC stimulus and its benefits; and the difference between the Government LTC and LTA prevalent in the corporate sector as pointed out in the said statement, it appears that the benefit of LTC stimulus has been extended to non-Central Government employees i.e. State and Local Government as well as public sector employees only and not to the private sector employees. In view of this confusion, it is desirable that the Ministry of Finance should provide appropriate clarifications for extending the LTC stimulus to private sector employees also. Further, there is a difference between the LTC scheme for Central Government employees (i.e., they are entitled to LTC only if they take leave and travel) and private sector employees (i.e. LTA is one of the components of salary package on the principle of "cost-to-company" wherein employees are paid LTA irrespective of actual travel). For the private sector employee exemption is allowed only if an employee avails of leave and travels and furnishes requisite evidences, failing which LTA is treated as taxable. In some cases, LTA is paid even on a monthly basis. Such distinction in the compensation structures of Government and private sector employees is recognized by the Central Government, as is evident from its press release dated 13 October 2020 issued to clarify certain misconceptions. Therefore, private sector employers will face the difficulty in modifying their compensation policy to accommodate the LTC Scheme to their employees, while ensuring that it is compliant with the parameters applicable to the Central Government employees. Therefore, the clarifications should also cover whether private sector employers can restructure their compensation package w.e.f. 12 October 2020 for offering the deemed LTC fare as a new component even in the absence of LTA in the existing package.*

Extension of Due dates in case of filing of return in a simple table format:

Sr. No	Nature of Compliance	Assessment Year	Original Due Date	Last extended Due Date	New Due Date
1	Belated return of Income	2019-20	31-3-2020	30-09-2020	30-11-2020
2	Revised Return of Income	2019-20	31-3-2020	30-09-2020	30-11-2020
3	Return of Income (In case of Company)	2020-21	31-10-2020	30-11-2020	31-01-2021
4	Return of Income (In case of Tax Audit)	2020-21	31-10-2020	30-11-2020	31-01-2021
5	Return of Income (In case of Transfer Pricing Audit)	2020-21	30-11-2020	No extension	31-01-2021
6	Filing of tax audit report and other reports	2020-21	30-09-2020	31-10-2020	31-12-2020
7	Return of Income (In any other case)	2020-21	31-07-2020	30-11-2020	31-12-2020

DID YOU KNOW?

Though the due date of filing return of income is extended, a Taxpayer having tax liability of more than INR 1 Lac on the original due date is liabile to pay interest @ 1% per month/part of the month till the date of filing the return.

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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