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 September 2021:

Income tax rulings

- **Disallowance of expenses under Section 14A not to apply in a case where own funds exceed borrowed funds**

  - South Indian Bank Ltd (Supreme Court) [TS-849-SC-2021]

  The Hon'ble Supreme Court ('SC') held that proportionate disallowance of expenses in accordance with Section 14A of the Income-tax Act, 1961 ('the Act') is not warranted if investments in securities are made out of funds comprising of both owned and borrowed sources and the taxpayer has available non-interest-bearing funds which exceed the amount of investments made in securities resulting in exempt income. In such cases, the taxpayer has the right of appropriation and also the right to assert from which part of the funds a particular investment is made.

  In arriving at this conclusion, the Hon'ble SC relied on its earlier decision in the case of CIT(LTU) vs. Reliance Industries Ltd (410 ITR 466) wherein it had held that if interest free funds available to a taxpayer were sufficient to meet its investment, it will be presumed that investments were made from such interest free funds. The SC also referred to a plethora of decisions of various High Courts such as in the case of HDFC Bank Ltd vs DCIT (383 ITR 529) (Bom), Pr. CIT vs Bombay Dyeing and Mfg. Co. Ltd. (ITA No. 1225 of 2015) (Bom), CIT vs Suzlon Energy Ltd (354 ITR 630) (Guj.), CIT vs Microlabs Ltd (383 ITR 490) (Kar) and CIT vs Max India Ltd 388 ITR 81 (P&H).

  The Hon'ble SC also observed that there was no legal obligation on the taxpayer to maintain separate accounts for different types of funds held by it.

  ***JMP Insights**: This ruling will no more apply to dividend income since Dividend Distribution Tax has been abolished and no tax free income is received by taxpayers. However, the taxpayers may rely on this ruling for pending litigation. The ruling should bring closure to several pending cases relating to Section 14A disallowances in favour of the taxpayer.*

- **Non-resident payee not liable to pay interest for short/non-payment of advance tax owing to default for short/non-deduction of tax by payer**

  - Mitsubishi Corporation (Supreme Court) [TS-869-SC-2021]

The SC has held that a non-resident payee was not liable to pay advance tax on account of non-deduction of tax at source by the payer and accordingly was also not liable to pay interest for short/non-payment of advance tax under Section 234B of the Act. In coming to this conclusion, the SC noted that the liability to pay interest for default in payment of advance tax is laid down in Section 234B and that Section 234B cannot be read in isolation of Chapter XVII. The pre-conditions of Section 234B i.e. liability to pay advance tax and non-payment or short payment of advance tax have to be satisfied and only thereafter, interest can be levied taking into account the amount of 'assessed tax', which is computed after considering tax deductible or collectible at source. Hence, interest is payable only once there is a default for non-payment of advance tax.

Further, the Revenue can proceed for recovery of tax against the payer who has defaulted in withholding appropriate tax.

The SC observed that this position in the law has changed from Financial Year ('FY') 2012-13 onwards by insertion of proviso to Section 209(1) of the Act. For all FYs prior to FY 2012-13, the taxpayer/payee should be allowed to reduce the tax which was otherwise required to be deductible even though no tax has actually been withheld.

***JMP Insights**: Many taxpayers, especially foreign companies which send their employees to India for upto a year or so miss the tax implications due to the insertion of this proviso to Section 209(1) of the Act. Since these companies do not have a presence in India, they fail to withhold tax on salary paid outside India to these employees. These companies may not only have to bear the consequences under the Act for not withholding tax on the salary payments, but also have to bear the extra interest cost on short payment of advance tax by the employees, as most employees come to India under net-of-tax contracts. It is therefore essential that a proper tax advice is taken by them so that their tax compliances are in order.*

- **Money received from Non Resident ('NR') treated as a non-taxable gift for Foreign Exchange Management Act, 1999 ('FEMA') non-compliance**

  - Crescent Payments Private Ltd (Mumbai ITAT) (ITA No. 559/Mum/2017)

The Mumbai Tribunal has held that share subscription money against which shares could not be allotted within six months of receipt of the subscription amount, thereby resulting in non-compliance under FEMA, is not to be taxed as income in the hands of the taxpayer.

In arriving at this decision, the Tribunal observed that the share subscription money was not received in the ordinary course of business of the taxpayer and no benefit which was revenue in nature had arisen from the business carried on by the taxpayer. Hence, the provisions of Section 28(iv) of the Act would not apply to this transaction. Thereafter, the Tribunal held that in order to attract the provisions of Section 56(2) of the Act, the money received should be first treated as income under Section 2(24) of the Act. The Tribunal analysed the provisions of clauses (vii), (viia) and (viib) of Section 56(2) of the Act and held that these provisions did not apply to the present case.

The Tribunal relied on the ruling of the Hon'ble Supreme Court in the case of GG.S. Homes & Hotels (P) Ltd vs DCIT (242 Taxman 58) and that of the Bombay HC in the case of Nerka Chemicals (P) Ltd vs Union of India (371 ITR 280) wherein it was held that the amount received on account of share capital cannot be treated as business income and hence, the amount received by the taxpayers was not held as taxable.

***JMP Insights**: This ruling pertains to FY 2011-12, which was prior to the introduction of Section 56(2)(x) of the Act. Subsequent to the introduction of Section 56(2)(x) which has a very wide ambit, it may need to be analysed to what extent reliance can be placed on this ruling.*

- **Advertisement charges paid by Myntra to Facebook not held as royalty; no liability to withhold tax**

  - Myntra Designs Pvt Ltd (Bangalore ITAT) [IT(IT)A Nos. 598 to 600/Bang/2020]

The Bangalore ITAT held that payments made by the taxpayer towards advertising charges to Facebook, Ireland are not taxable as royalty. Accordingly, there was no requirement to withhold tax under Section 195 of the Act and consequently the taxpayer cannot be considered as being in default for not withholding taxes.

In arriving at this conclusion, the ITAT relied on its own earlier decision in the case of Urban Ladder Home Décor Solutions P Ltd [IT(IT)A No. 615 to 620/Bang/2020] where under similar facts it was held that Facebook only allows the taxpayer to use their facilities for the purpose of creating advertisement content. In this ruling, the ITAT had further observed that Facebook does not give any specific license for use or right to use any of the facilities (which include software) and those facilities were not going to be used in the business of the taxpayer. The right to use those facilities was intertwined with the main objective of placing advertisements with Facebook. Hence, the question of transferring the copyright over those facilities does not arise at all. On a perusal of the relevant extracts of the agreements, the ITAT had observed that it was clear that the copyright over those facilitating software was not shared with the taxpayer. The main purpose of making payments was to place advertisements only and not to use the facilities provided by Facebook. Thus, the facilities provided by Facebook are only enabling facilities, which help a person to place advertisement content on the platform of Facebook effectively.

***JMP Insights**: This ruling once again lays down the principle that a payment can be taxed as royalty in India only if there is a transfer of copyright. Mere use or right to use of facility/equipment granted through a license is not taxable as royalty. Going forward, it will be important to analyse the implications of Equalisation Levy in similar cases.*

Notifications

- **Rule 9D of the Income Tax Rules, 1962 ('the Rules') relating to computation of taxable interest on certain Provident Fund contributions**

  Finance Act, 2021 has withdrawn the tax exemption for interest paid to an employee on Provident Fund ('PF') to which the Provident Fund Act, 1925 applies or from a Recognised PF, to the extent the interest pertains to contributions exceeding INR 250,000 made by the employee in the aggregate during the relevant FY in the said PF.

  In this connection, Rule 9D has been introduced to provide the method to compute the taxable interest on PF contributions. Rule 9D prescribes that separate accounts within the PF account shall be maintained for FY 2021-22 and all subsequent FYs for taxable contributions and non-taxable contributions made by a person.

  Taxable Contributions shall be the aggregate of contributions made in FY 2021-22 and subsequent FYs in excess of the specified threshold and the amount of interest accrued thereon and reduced by the amount of withdrawal, if any, from such account. The specified threshold is INR 500,000 per FY in cases where there is no contribution by the employer towards PF. In all other cases, the threshold is INR 250,000 per FY.

  Non-Taxable Contributions shall be the aggregate of the closing balance as on 31 March 2021, contributions made for FY 2021-22 and subsequent FYs which are not taxable contributions and interest accrued on both and reduced by the amount of withdrawal, if any, from such account.

  ***JMP Insights**: Clarification is required on whether the individual has a choice whether to withdraw funds from the taxable account or non-taxable account. One will have to wait and watch various aspects of implementation of the Rule.*

- **New Rule 10RB notified to prescribe the mechanism to compute relief from tax payable on book profits in case of APAs and secondary adjustment**

  As per Section 115JB(2D) of the Act, in the case of corporate taxpayers, where there is an increase in book profits owing to the income of past years being included in the book profits on account of an Advance Pricing Agreement ('APA') or on account of secondary adjustment and if the taxpayer makes an application to the tax officer in this regard, the tax officer is required to re-compute the book profit and tax payable for the past years.

  In this connection, new Rule 10RB prescribes the mechanism to compute the relief from tax payable. The rule is akin to the relief claimed by individual salaried taxpayers under Section 89 on receipt of arrears.

  The tax credit/MAT credit shall be reduced to the extent of relief claimed under this new rule. The relief needs to be claimed electronically in the prescribed form and manner.

  As per Rule 10RB, the relief is to be worked out as follows:

(A-B) – (D-C)

- A denotes tax payable on book profit of the concerned year including the past income
- B denotes tax payable on book profit of the concerned year excluding the past income
- C denotes aggregate tax payable on book profits of those past years ignoring the past income
- D denotes aggregate tax payable on book profits of those past years by increasing the book profit with the relevant past income

If the value of (A-B) or (D-C) is negative, then it should be deemed to be zero. Further, if there is no tax which becomes payable after arriving at values of A, B, C or D, then the values of A, B, C or D shall be deemed to be zero for computing the relief.

DID YOU KNOW?

CBDT has extended the applicability of the Safe Harbour Rules until AY 2021-22 i.e. FY 2020-21. The Safe Harbour Rules are a set of circumstances where the transfer price declared by the taxpayer for eligible international transactions is accepted by the tax authorities.

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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