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 2021:

Income tax rulings

- **Director of a private limited company liable to tax in case of default by the company, internal agreement between directors not valid, burden of proving no misfeasance or gross neglect is on the director.**

  - Rajeev Behl (Delhi HC) [W.P.(C).7869/2021 & CM APPL.24474-475/2021]

  The Delhi High Court ('HC') has held that the arbitral agreement between the directors of a private limited company for apportionment of income tax liability of the company does not bind a statutory authority, such as the Income Tax Department. Thus, on failure of recovery of the income tax from the private limited company, the Income Tax Department, under Section 179 of the Income-tax Act,1961 ('the Act') has full right to proceed against the directors who held the office during the relevant year(s) to which the income tax demand pertains.

  In arriving at this decision, the HC relied on the decision of the Hon'ble Supreme Court ('SC') in the case of Booz Allen & Hamilton Inc. vs SBI Home Finance Limited & Ors (Civil Appeal No. 5440 of 2002). In this case, the SC has held that while rights in personam (rights against a particular person) are arbitrable, rights in rem (rights against the entire world) are unsuited for private arbitration and can only be adjudicated by the Courts or Tribunals.

  Further, the HC also observed that Section 179 of the Act casts a liability on the director to prove that non-recovery of income tax is not attributable to gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company, once the Income Tax Department has demonstrated that the tax dues could not be recovered from the company. In this connection, the HC also placed reliance on the Bombay HC ruling in the case of Union of India vs Manik Dattatreya Lotlikar [1987] 35 Taxman 526 (Bombay).

  JMP Insights – *It is important for individuals who are directors of private limited companies to manage their affairs carefully and ensure proper compliance by the company, even from a tax perspective, as they can be held personally liable in case of tax defaults by the company.*

- **Corporate guarantee considered to be international transaction, following non-jurisdictional HC's ruling as against the taxpayer's own case for prior years.**

  - Siro Clinpharm Pvt Ltd [Mumbai Income Tax Appellate Tribunal ('ITAT')] [ITA No. 847/Mum/2016]

  The Mumbai ITAT has ruled that in a hierarchical judicial system, once a judicial forum, higher in authority has ruled on a particular issue, the better wisdom of the forum/Court below, must yield to the higher wisdom of the forum/Court above. In absence of a contrary decision from the jurisdictional HC, the decision of a non-jurisdictional HC needs to be followed, unless there are strong and specific reasons to not consider the same. In view of the above, despite the fact that the co-ordinate bench of the ITAT had in respect of past year ruled in the taxpayer's own case that corporate guarantee is not an international transaction, the ruling of Madras HC in the case of Principal Commissioner of Income Tax vs Redington India Ltd [TCA No. 590-591 of 2019], expressing a contrary view needs to be followed now, being a ruling from a higher judicial forum.

  In arriving at this decision, the ITAT relied on the decision of the Hon'ble SC in the case of Assistant Collector of Central Excise vs Dunlop India Ltd [(1985) 154 ITR 172 (SC)] and the decision of the Bombay HC in the case of Commissioner of Income Tax ('CIT') vs. Godavari Devi Saraf [(1979) 113 ITR 589 (Bom)] and emphasis was supplied from the ruling of co-ordinate bench of the ITAT in the case of Bank of India vs. Assistant CIT [(2020) 122 taxmann.com 247 (Mum)].

  However, the ITAT allowed the grounds of the taxpayer to a limited extent, by reducing the corporate guarantee commission from 3% as considered by the Assessing Officer to 0.5%, relying on the decision of the Bombay HC in the case of CIT Vs Everest Kento Cylinders Ltd [(2015) 58 taxmann.com 152 (Bom)].

  Further, under the transfer pricing adjustments, the ITAT observed that it is a settled legal position that wherever relevant segmental data is available and is not disputed, the segmental data is a better comparable than the entity level data.

  JMP Insights – *Whenever a taxpayer is adopting the same view in their tax return as has been held in their case in the past, they also need to be mindful of the subsequent judicial developments in this regards, especially if a higher judicial forum has taken a different view.*

- **Borrower not liable to deduct tax on fees paid to asset valuer by lender bank and later recovered from borrower.**

  - Hindustan Organic Chemical Limited (Mumbai ITAT) [ITA No. 7918/Mum/2019]

  The Mumbai ITAT has ruled that in case of fees paid by the lender bank to asset valuer (appointed by the bank), exclusively for the purpose of submitting valuation report of the assets of the borrower, and later recovered from the borrower, is not subject to deduction of tax by the borrower. The services were assigned to the valuer by the bank and rendered

by the valuer to the bank, for safeguarding the bank's interests. Hence, mere recovery of the fees from the borrower does not make the borrower liable to deduct tax and in turn, the disallowance of such amount under Section 40(a)(ia) of the Act was deleted.

Further, the ITAT held that expenses pertaining to prior years, but crystallized and quantified during the current year, cannot be merely disallowed on the grounds that the taxpayer follows the mercantile system of accounting.

In arriving at this decision, the ITAT has relied on the decision of the Gujarat HC in the case of Saurashtra Cement & Chemical Industries Ltd vs CIT [1995] 213 ITR 523 (Gujarat). In the Gujarat HC case, it is clearly mentioned that if the necessary material crystallizing the expenditure is not in existence in respect of which such income or expense relates, the mercantile system does not call for an adjustment in the books of accounts on estimated basis. An estimated income or liability, which is yet to be crystallized, can only be adjusted as contingency item but not as an accrued income or liability of that year.

- **Re-assessment notice issued after 31 March 2021, quashed for not following new procedure laid down by Finance Act, 2021, where income has escaped assessment.**

  - Ashok Kumar Agarwal (Allahabad HC) [Writ Tax No. 524 0f 2021]

The Allahabad HC has quashed the reassessment notice for not following the provisions, substituted by Finance Act, 2021, for issuance of notice after 31 March 2021, where income has escaped assessment. Few of the crucial findings of the HC to conclude and quash the reassessment proceedings under the pre-existed law are as follows:

- Substitution of the old provision obliterates the pre-existing provision.

- In absence of any saving clause for the pre-amended provisions either under the Ordinance, or the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 ('TOLA') or the Finance Act, 2021, there existed no presumption in favour of the old provision continuing to operate beyond 31 March 2021.

- The words 'assessment' or 'reassessment' appearing in the notifications issued under TOLA should be read to be indicative of proceedings commenced prior to 1 April 2021 and the delegated legislation under TOLA could not create an overriding effect in favour of itself.

- Section 3(1) of TOLA did not itself speak of reassessment proceeding or of section 147 or section 148 of the Act, as it existed prior to 1 April 2021. It only provides a general relaxation of limitation granted on account of general hardship existing upon the spread of pandemic COVID-19. After enforcement of the Finance Act, 2021, it applies to the substituted provisions and not the pre-existing provisions.

- The delegated legislation cannot defeat the principle legislation.

- Non-obstante clause in section 3 of the TOLA cannot be given a wider meaning or application which could defeat the other laws.

- Mischief Rule has no application in the present case to rescue the constitutional validity of any clause as there is plain legislative action in existence which would devoid any argument of two interpretations.

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Revenue relied on the Chhattisgarh HC ruling in case of Palak Khatuja [W.P. (T) No. 149 of 2021] which is on the same grounds but Allahabad HC distinguished the case and held that it was unable to persuade itself to that view. Allahabad HC, thus held in the impugned case, that "no presumption exists that by notification issued under the enabling Act, the operation of the pre-existing provision of the Act stands extended and thereby provisions of Section 148A of the Act and other provisions have been deferred".

JMP Insights – *Under the Finance Act, 2021, the government has completely overhauled the re-assessment proceedings. The new re-assessment procedure is applicable w.e.f 1 April 2021. As per the tax authorities, the TOLA has extended the old regime of re-assessment under section 147 and 148 of the Act till 30 June 2021.The debatable question is, what is the validity of the notice(s) issued under 148 of the Act which are issued, on or after 1 April 2021, as per the old regime.*

As of 1 November 2021, the Delhi HC has concluded hearing on a batch of over 1300 petitions relating to validity of reassessment notices issued under the old regime after 1 April 2021 and has reserved its judgement.

- **Standard automated services sans human intervention not taxable as Fees for Technical Services ('FTS')**

  - Hitachi Metglas (India) Pvt. Ltd (Delhi ITAT) (ITA No.3694/Del/2016)

The Delhi ITAT has confirmed the position that payments for standard, automated support services in the nature of standard connectivity and networking services without any human intervention cannot be termed as FTS within the meaning of section 9(1)(vii) of the Act. It was further held that the taxpayer was not required to deduct tax at source, consequentially deleting the disallowance of expenses made for non-deduction of tax at source.

In arriving at this conclusion, the ITAT has relied on the decision of the SC in the case of CIT vs Kotak Securities Ltd. [2016] 383 ITR 1 (SC) wherein the Hon'ble SC held that common or standard services provided to every member who wants to trade on the stock exchange cannot be termed as FTS. The ITAT has also given reference to various landmark rulings which include CIT vs Media World Wide (P.) Ltd [2020] 120 taxmann.com 423 [Cal HC], CIT vs ESTEL Communication (P.) Ltd [2008] 318 ITR 185 (Del HC) and CIT vs Bharti Cellular Ltd [2008] 319 ITR 139 (Del HC).

Notifications

- **Central Board of Direct Taxes ('CBDT') prescribes conditions to claim relief on offshore indirect transfer of Indian assets.**

The Taxation Laws (Amendment) Act, 2021 ('the Amendment Act') inserted three provisos (Fourth, Fifth and Sixth Proviso) in Explanation 5 to section 9(1)(i) of the Act to give relief to certain eligible entities impacted by the retrospective amendment made to Section 9 of the Act, by the Finance Act, 2012.

These amendments provide that the provisions of indirect transfer of assets in India shall not apply to the assets transferred before 28 May 2012, (i.e. the date on which the Finance Bill, 2012 received the assent of the President) subject to fulfilment of certain conditions. Accordingly, all pending assessments shall be deemed to have been concluded without additions for such income.

The CBDT had issued the draft rules on 28 August 2021 prescribing the specified conditions to claim the above relief. After examining the stakeholder comments on the draft rules, the CBDT has notified the final rules vide Notification No. GSR 713(E), dated 1 October 2021 wherein the following rules have been inserted to the Income-tax Rules, 1962:

(a) Rule 11UE provides for the specified conditions in order to be eligible to claim relief under the Amendment Act; and

(b) Rule 11UF provides the form and manner of furnishing the undertaking for withdrawal of pending litigation, claiming no cost, damages, etc.

DID YOU KNOW?

- *The Organisation for Economic Cooperation and Development ('OECD') has introduced a major international tax reform, directed to ensure that Multinational Enterprises ('MNEs') with revenues greater than EUR 750 million will be subject to a minimum corporate income tax rate of 15% from 2023. This has been agreed by 136 countries under the aegis of the OECD and is estimated to raise additional annual USD 150 billion in global tax revenues.*

- *The Annual Information Statement ('AIS'), which is a revamped version of Form 26AS (annual tax credit statement issued by Income Tax Department) is now live on the new Income Tax portal for Financial Year ('FY') 2020-21. The AIS aims to provide a complete profile of a taxpayer, disclosing details of various transactions such as interest and dividends received, transactions in securities, mutual fund transactions, information on foreign remittances and so on. Through the AIS, the Income Tax Department wishes to promote transparency and simplify the tax return filing process.*

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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