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 November 2021:

Income tax rulings

- **Unexplained investment in India by non-resident from income earned outside India, not taxable in India under section 69 of Income-tax Act, 1961 ('the Act')**

  - Rajeev Suresh Ghai (Mumbai Tribunal) [ITA No. 6290/Mum/2019]

Taxpayer, an Indian national and a tax resident of the UAE, had paid cash aggregating to INR 2.5 crore to a builder for purchasing a property in India. The assessing officer treated the amount paid to the builder as an unexplained investment and the value of the investment was treated as deemed income under section 69 of the Act.

The Mumbai Tribunal noted that the trigger for taxability is unexplained *investment in* immovable property. Bearing this in mind, it examined the tax treaty provisions under which the income can be brought to tax. It observed that such income is not specifically taxed under any of the heads in the India-UAE tax treaty. That would take one to Article 22 of the tax treaty dealing with 'other income'. As per this Article, items of income of a resident of a Contracting State wherever arising shall be taxable only in that State. As per the Tribunal, the deemed income due to unexplained investment cannot be taxed even under this Article. This is so because while this Article gives the taxing rights to the resident state (which is the UAE) it is not even a case that the income has arisen in India. The case is that the income has been invested in India and the unexplained investments are inherently in the nature of application of income rather than earning of income. The Tribunal held that since India is neither a state of residence nor a state of source (as no economic activities were carried out in India) by no stretch of logic can such an income be taxed in India under the India-UAE tax treaty.

***JMP Insights** –This is an interesting decision, especially for non-resident investors who have invested in India using their overseas funds but have found themselves embroiled in tax litigation in India. Another important point that needs discussion is whether an assessing officer has jurisdiction to question any investment in India if it can be demonstrated that the income from which such investment was made was earned from sources outside India at the time when the person was a non-resident in India.*

- **Fees paid to Polish Law firm not taxable in India, follows Linklater's ruling**

  - Infosys BPO Ltd (Bangalore Tribunal) [ITA No. 986/Bang/2017]

The taxpayer in this case had grossed up the invoice amount and paid TDS on the fees paid for the legal services rendered by the Polish Law firm. The said TDS was deducted and deposited by the Taxpayer under protest. Taxpayer had filed an application before CIT(A), seeking declaration that no tax was deductible on the payment made to the Polish firm.

Revenue contended that the payment made to the Polish Law firm falls under the ambit of 'Royalties and fees for technical services' and was accordingly chargeable to tax in India as per section 9(1)(vii) of the Act as well as Article 13(4) of India Poland-Tax treaty.

The Bangalore Tribunal held that a partnership firm is a fiscally transparent entity under Polish Law and the partners did not have Permanent Establishment in India. The taxability of income was examined under Article 15 of India Poland Tax Treaty. The Tribunal by placing reliance on Mumbai Tribunal ruling in the case of Linklaters LLP (2017) 79 taxman.com 12, case and the OECD commentary held that since the income of the partnership "flows through" to the partners under the domestic law of that State (Poland), the partners are the persons who are liable to tax on that income and are thus the appropriate persons to claim the benefits of the Tax Treaties.

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***JMP Insights** – It is pertinent to note that in Linklaters LLP's case Article 15 of India UK tax treaty was examined. Article 15(1) of the India UK tax treaty starts with: "Income derived by an individual who is a resident of a Contracting State…". Article 15(1) of the India Poland tax treaty however starts with: "Income derived by an individual, whether in his own capacity or as a member of a partnership. As such, the words "whether in his own capacity or as a member of a partnership" are absent in the India-Poland tax treaty. Nevertheless, the benefit of Article 15 has been extended to the above case. Based on this ruling, one may take a view that fiscally transparent entities can avail the benefit under the Article on Independent Personal Services of the tax treaties, as long as the conditions mentioned in that Article are satisfied.*

- **When demand is determined on regular assessment, interest on income tax refund initially granted shall not be taxable income in the year of receipt.**

  - Honeywell Automation India Ltd [Pune Income Tax Appellate Tribunal] (ITA No. 332/PUN/2021)

The Pune Tribunal has held that where the income tax refund initially granted (at the time of processing the return) together with interest thereon, was wiped out due to a demand being determined after regular assessment, the fact that the interest on income tax refund was not offered to tax in the year when it was initially received, would be revenue-neutral. Even if the Taxpayer would have offered the interest on refund in the year of receipt, to tax, it would have to be rectified and deleted in the subsequent year in which regular assessment was concluded and demand was determined.

The Tribunal further held that secondary and higher education cess paid on income tax is not a disallowable expenditure under Section 40(a)(ii) of the IT Act. In doing so, the Tribunal placed reliance on the decision of the Bombay High Court ('HC') in the case of Sesa Goa Ltd. [2020] 423 ITR 426 (Bom-HC) and the decision of the Rajasthan HC in the case of Chambal Fertilizers and Chemicals Ltd., and Another vs. JCIT [2018] 102 CCH 0202 (Raj-HC).

JMP Insights – *It needs to be understood that generally the year of receiving income tax refund and the year in which the demand is determined on conclusion of scrutiny assessment would be different. It cannot be foreseen in the year of receipt of refund that the refund may be reversed in the subsequent years. Hence, a tax payer may consider offering the interest on refund to tax in the year in which it is received and applying for rectification under Section 154 of the Act to delete the interest on refund already offered to tax, if the regular assessment reversing the refund is concluded. However, there may be practical challenges in convincing the revenue authorities for a refund under this route.*

- **Limited scrutiny assessment cannot be revised by the Principal Chief Commissioner of Income Tax ('PCIT') beyond the scope of original scrutiny**

  - Antariksh Realtors Private Limited (Mumbai Tribunal) [ITA No.1626/Mum/2020]

The taxpayer's case was selected for limited scrutiny on two grounds:

- Low income in comparison to high loans/advances/investment in shares appearing in balance sheet and
- MAT liability mismatch

The assessing officer had framed the assessment accordingly. The PCIT exercised jurisdiction under section 263 of the Act and directed the assessing officer to make fresh assessment to make an inquiry for the purpose of availing loans, which was *not* the subject matter of limited scrutiny.

The order passed by the assessing officer can be revised by the PCIT under section 263 of the Act if two conditions are satisfied; first being that the order passed by the assessing officer is erroneous i.e. among other things, the order is passed by the assessing officer without making inquiries or verification which should have been made and second being the order passed is prejudicial to the interest of the revenue.

The Mumbai Tribunal in its ruling has held that the PCIT has exceeded his jurisdiction by expanding the scope of the limited scrutiny. Further it was held that the issue was also not prejudicial to the interest of the revenue and hence it did not fall under the section 263 of the Act. The Tribunal held that if the assessing officers are not empowered to do certain acts directly, the PCIT certainly cannot direct it indirectly by misusing the power under section 263 of the Act.

***JMP Insights** – The Tribunal followed the decision of the Mumbai bench decision in the case of Su-Raj Diamonds Dealers Pvt. Ltd (*ITA No.3098/Mum/2019 order dated 27-11-2019*) confirming the decision that the PCIT or CIT cannot misuse the power and analyse more details other than the scope mentioned in the limited scrutiny.*

- **Use of agricultural land for non-agricultural purposes by the buyer does not make the seller liable for capital gains**

  - Cochin Malabar Estates & Industries Ltd [Kerala High Court ('HC')] (ITA No. 179 of 2014)

The Kerala HC has ruled that the character of land as at the date of sale/transfer is the relevant point of time for determining whether the land is agricultural or non-agricultural. When the land is arable (fit for cultivation) and continues to be classified as agricultural for land revenue purposes as on the date of sale, it cannot be classified as non-agricultural merely because the buyer is possibly going to use it for non-agricultural purposes.

In arriving at this conclusion, the HC has relied on the decision of the Madras HC in the case of Srinivasa Naicker vs. ITO [2007] 292 ITR 481 wherein the HC held that the chargeability to tax under section 45 of the Act, arises only if on the date of sale, the land in question retained its character as a capital asset. This means that an asset which does not answer the definition of a capital asset and which is an agricultural land falling within the definition of section 2(14) of the Act would automatically be outside the scope of section 45 of the Act.

Notification

- **Computation of deemed Arm's Length Price for Assessment Year ('AY') 2021-22 (NOTIFICATION S.O. 4586(E) dated 29-10-2021)**

The Central Board of Direct Taxes (CBDT) has notified the price variation tolerance limits for Arm's Length Price (ALP) determination for AY 2021-22. Accordingly, if variation between the arm's length price determined under section 92C of the Act and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one per cent of the latter and three per cent of the latter in all other cases, then the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for AY 2021-22. These limits are similar to those notified in respect of AY 2020-21.

'Wholesale Trading' is defined as an international transaction or specified domestic transaction of trading in goods, which fulfils certain conditions as mentioned in the Notification.

DID YOU KNOW?

Insolvency and Bankruptcy Board of India has clarified that there is no requirement of seeking a No Objection Certificate or No Dues Certificate from Income Tax Department during the Voluntary Liquidation Process. (Circular No IBBI/LIQ/45/2021 dated 15th November 2021). This will ease the process of voluntary liquidation which otherwise takes a substantial amount of time.

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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