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 April 2022:

Income tax rulings

- **Honourable Supreme Court ('SC') strikes balance between revenue's and assessee's rights to settle reassessment controversy and modifies the rulings of the High Courts ('HC') by invoking Article 142 of the Constitution of India.**

  - Union of India & Others v. Ashish Agarwal (SC) (Civil Appeal No. 3005/2022)

The issue under consideration was whether notices issued on or after 1 April 2021 towards the initiation of reassessment proceedings under the provisions of the Income tax Act, 1961 ('the Act') as they existed before 1 April 2021 are to be treated as bad in law.

Various HCs had ruled in favour of the taxpayer and held that the reassessment notices issued under the erstwhile provisions to be bad in law for the following reasons:

- In absence of any saving clause in the amended provisions of the Act, the erstwhile provisions would not apply from 1 April 2021.
- The Taxation and Other laws (Relaxation and Amendment of Certain Provisions) Act,2020 ('Relaxation Act') extended the issuance of notice under old provisions until 30 June 2021.
- Even though the aforesaid Relaxation Act was in existence when the Finance Act, 2021 was passed, the Parliament has specifically made the amended provisions (sections 147 to 151 of the Act) as being applicable with effect from 1 April 2021.Therefore, the intention of the legislature is clear that substituted provisions must apply to notices issued with effect from 1 April 2021.
- In absence of adherence to the procedure as per new section 148A of the Act, the reopening notices issued on or after 1 April 2021 are invalid.

However, the SC observed that the decision of several HCs which considered the reassessment notices issued under the erstwhile provisions to be bad in law would result in no proceedings at all and would frustrate the object and purpose of reassessment proceedings. Accordingly, the SC modified the decisions passed by various HCs as follows:

- The notices issued under the erstwhile provisions shall deemed to have been issued under the new provisions and treated to be show cause notices as per section 148A(b) of the Act. The tax officer shall, within 30 days from the date of this SC order (4 May 2022),

provide to the taxpayer information and material relied upon by the tax officer so that the taxpayer can reply to the notices within two weeks thereafter.

- The requirement of conducting enquiry as per section 148A(a) of the Act shall be dispensed with as a one-time measure.

- All the defences available to taxpayer and rights to the tax officer as prescribed under the Finance Act, 2021 shall continue to be available.

The present order is passed in exercise of powers under Article 142 of the Constitution of India so as to avoid any further appeals by the revenue on the issue by challenging similar decisions and orders, with a view not to burden the courts with more than 9,000 appeals. This decision shall also govern the pending writs before various HCs on similar issue.

JMP Insights *- The decision of the SC has put a quietus on the long pending litigation at a pan India level on this issue. However, the decision to treat the notices issued under old regime as deemed to be issued under new regime could entail a different set of litigation. While the notices were originally issued keeping the old provisions in hand, the same notices now need to be fitted into the new provisions subject to new conditions and should comply with the provisions of new regime.*

Even the tax authorities needed clarity on the implementation of the judgement of SC on various aspects. In response to that, the Central Board of Direct Taxes ('CBDT') has issued Instructions No. 01/2022 to bring clarity/provide instructions on several such aspects to help/direct the tax officers implement the SC judgement.

➢ **Validity of assessment order issued in the name of amalgamating company post amalgamation**

- Mahagun Realtors (P) Ltd (SC) [SLP (C) No. 4063 of 2020]

In the given case, Mahagun Realtors (P) Ltd ('taxpayer / MRPL/amalgamating company') was amalgamated with Mahagun India Private Limited ('MIPL/amalgamated company') by order of the HC dated 10 September 2007. The tax officer passed the assessment order for Financial Year ('FY') 2005-06 in the name of amalgamating company as represented by the amalgamated company. The taxpayer filed appeals before the Commissioner of Income Tax (Appeals) ['CIT(A)'] and Income Tax Appellate Tribunal ('ITAT') mentioning the name of the 'appellant' as 'MRPL as represented by MIPL'. It is during the appeal before the ITAT that the taxpayer raised an objection on the validity of the assessment in view of amalgamation.

The SC dealt with the aspect of validity of an assessment order issued in the name of amalgamating company post amalgamation. While rendering the decision in favour of the tax authorities, the SC held as under:

- Amalgamation is not like the winding-up of a corporate entity. In the case of amalgamation, the outer shell of the corporate entity is undoubtedly destroyed, and it ceases to exist. However, in every other sense of the term, the corporate venture

continues, enfolded within the new or the existing transferee entity. In other words, the business and the adventure lives on but within a new corporate residence i.e., the transferee company.

- It factually distinguished the SC decision in the case of Principal Chief Commissioner of Income-tax ('PCCIT') v. Maruti Suzuki India Ltd [2019] SCC Online SC 928 and Delhi HC decision in case of Spice Infotainment Ltd v. CIT (2020) 247 ITR 500 on the basis that in those decisions the taxpayers had duly informed the lower authorities about the merger of companies and yet an assessment order was passed in the name of amalgamating company/non-existing company. In the present case, there was no intimation by the taxpayer regarding amalgamation with MIPL at any stage of the assessment proceedings. Further, in the referred cases, the amalgamated companies had participated in the proceedings before the tax authorities. However, in the present case, the participation in proceedings was in the name of MRPL itself.

- The SC further observed various other factors including the fact that there was a clause in the scheme of amalgamation which provided that MRPL's liability would devolve in MIPL. Further, the return of income filed by MRPL did not mention the fact of amalgamation despite the presence of such specific reporting requirements in the return of income. Also, in a counter affidavit filed before the SC, the affirming party was described as Directors of the amalgamating company.

- Relying on the specific facts of the case, the SC held that the notice issued in the name of MRPL stands valid, and the matter was restored back to the ITAT for deciding on the merits of the appeal.

JMP Insights *– While distinguishing the facts of this case with that of the earlier SC decisions, the SC has highlighted that intimation of the fact of the merger by the assessee to the tax authorities is necessary. This is an important aspect to be noted by the taxpayers contemplating or undergoing merger exercises. It is essential that due disclosures be made in the communications to the tax authorities, return forms, other income tax filings, etc., about the merger. If one consistently holds itself out as the taxpayer, it cannot subsequently argue that it is non-existent.*

➢ **Finance loss on forex loan repayment taken for business expansion allowable under Section 37 of the Act**

- Wipro Finance Limited (SC) [Civil Appeal No.6677 of 2008]

The taxpayer, engaged in the business of financing to existing Indian enterprises for procurement or acquisition of equipment, plant and machineries on lease and hire purchase basis, had borrowed a foreign currency loan of GBP 5 million from a foreign corporation.

The taxpayer claimed revenue deduction for loss of ~INR 11.05 million arising on account of foreign exchange fluctuation.

The tax authorities disallowed the claim of forex loss of ~INR 11.05 million on the ground that it is capital in nature.

During the appellate proceedings, the taxpayer claimed additional forex loss of ~INR 24.6 million that was capitalized in the return of income, thereby claiming deduction of entire loss of ~INR 35.65 million.

The SC ruled in favour of the taxpayer by allowing the entire forex loss of ~INR 35.65 million as revenue deduction and held as under:

- The borrowing of money by the taxpayer was necessary for carrying on its business of financing. It was certainly not for creation of the taxpayer's asset as such or acquisition of an asset from abroad and hence special provisions of Section 43A of the Act is not applicable. The loan is exclusively used for the purpose of business of financing (through leasing or hire purchase) the existing Indian enterprises who in turn had to acquire plant, machinery and equipment to be used by them.

- It is true that there is limitation on the powers of the tax authorities to entertain fresh claims during assessment in view of the ratio of SC ruling in the case of Goetze (India) Ltd v. CIT (2006) (157 Taxman 1). However, the ruling itself makes it clear that such limitation would not impinge upon the plenary powers of the ITAT to accept fresh claims.

➢ **Cloud Hosting services provided by US Company to Indian customers is not taxable as 'royalty' under Article 12 of India-US Double Taxation Avoidance Agreement ('DTAA')**

- MOL Corporation (Delhi ITAT) [ITA NO. 1554 (DELHI) OF 2016]

The taxpayer earned revenue from licensing of Microsoft software products and from online services termed as cloud services. The taxpayer contended that the receipts are not taxable in India. The tax officer was of the view that income earned will be taxable as royalty under the domestic provisions of the Act and under the India-US DTAA.

The ITAT, on the basis of principles of law contended that sale of software products does not give rise to royalty income as laid down by the Delhi HC in Director of Income Tax v. Infrasoft Ltd [2014] (220 Taxman 273) which has been further affirmed by SC in the case of Engineering Analysis Centre of Excellence P. Ltd v. CIT (125 taxmann.com 42).

For taxability on cloud hosting services, reliance was placed by the taxpayer on the Delhi ITAT judgement in the case of M/s. Salesforce.com Singapore Pte. (ITA No. 4915/DEL/2016) and contended that subscription to cloud hosting services does not give rise to any royalty income. The ITAT ruled that the cloud services do not involve any transfer of rights to the customer and the grant of the right to install and use of the software did not include providing any copy of the said software to the customer. The cloud based services are based on patents/copyright, but the subscriber does not get any right of reproduction. The ITAT finally concluded that fees received towards cloud hosting services was not royalty but merely a

consideration for online access of the cloud hosting services for processing and storage of data to run the application.

Notifications and Circulars

- **CBDT notifies Rule 21AAA of Income-tax Rules, 1962 ('the Rules') for claiming tax relief on income arising from foreign retirement funds**

The Finance Act, 2021 had introduced new Section 89A of the Act, to claim relief from taxation of income from Retirement Benefit Account ('RBA') maintained in a notified country by a specified person.

A new Rule 21AAA has been notified vide CBDT Notification No 24 of 2022 dated 4 April 2022. As per the said Notification, where income has accrued to a 'specified person' in his 'specified account(s)' during the FY 2021-22 or later, then such taxpayer has an option to include such income in his total income in India in the year of withdrawal or redemption. This means that tax on income from such specified account can be deferred from the year of accrual to the year of redemption/withdrawal of such funds lying in the specified account in the specified country.

The term specified person and specified account has been defined in the CBDT Notification.

Where such specified person has exercised the option provided under Rule 21AAA of the Rules, the total income of the specified person for the year in which income is taxable shall not include the following income:

- The income which is already included in the total income in any of the earlier years during which such income accrued and tax had been paid thereon in accordance with provisions of the Act; or

- The income was not taxable in India in earlier years on account of:
  i. such specified person being Non- Resident or Resident but not ordinary resident during those earlier years; or
  ii. application of DTAA, if any, with that notified Country.

Further, the foreign taxes paid on such income shall be ignored for the purpose of foreign tax credit.

The option can be exercised by furnishing Form no 10-EE on or before the due date of filing tax return for relevant tax year. Also, once the option is exercised, the said option would apply to all subsequent years and cannot be withdrawn.

In case where specified person becomes a Non-Resident ('NR') during any FY then -

- The option exercised will be deemed to have never been exercised with effect from the relevant FY; and

- The income accrued in specified account from the FY in which the option was exercised, until the year prior to the FY when he becomes an NR, shall be taxable in the year prior to the year in which he/she becomes a NR.

***JMP Insights** – Introduction of the said rules and forms has operationalized the relief by way of deferral of taxation on income accrued on specified RBAs.*

Since this deferral option is with effect from FY 2021-22, one may have to be careful on how he/she has treated his/her income earned on such specified account in the past. If such income earned in the past was not offered to tax on the basis that in the country in which such RBA is maintained, taxes it in the year of withdrawal/redemption, then it is advisable that he/she has a relook at the position so taken.

➢ **CBDT notifies e-Dispute Resolution Scheme, 2022**

The Finance Act, 2021 inserted section 245MA of the Act to provide for the constitution of Dispute Resolution Committee ('DRC'). The DRC will provide an opportunity to resolve disputes arising from any variation in the 'specified order' and on fulfilment of such 'specified conditions' as may be prescribed by the CBDT. The DRC will help to resolve disputes of small taxpayers having a total income of upto INR 50 lakh and a disputed income of upto INR 10 lakh.

The CBDT has notified rules for constitution of DRC and also notified e-Dispute Resolution Scheme, 2022 ('the Scheme'). The salient features of the Scheme are as under:

- Application under the scheme to be filed electronically within the prescribed timeline before the DRC designated for the region of the jurisdictional PCCIT.
- Application to be filed in Form No. 34BC and accompanied by a fee of INR 1,000.
- On the taxpayers' request, the scheme allows the taxpayer a personal hearing through video telephony or video conferencing facility, to the extent technologically feasible, in accordance with the procedure laid down by the CBDT.
- DRC may examine the application and may accept or reject the application after considering the response filed by the taxpayer and communicate its outcome on registered email address of the taxpayer.
- If the application is accepted, then the taxpayer is required to withdraw the appeal filed before the CIT(A) or withdraw the application filed before the Dispute Resolution Panel and communicate a proof of such withdrawal within 30 days of receipt of the communication of acceptance of the application from the DRC.
- The DRC shall have the power to waive penalty or grant immunity from prosecution or both, in respect of the order which is the subject matter of resolution, on fulfilment of certain specified conditions.

JMP Insights *– The notified e-Dispute Resolution Scheme will help the taxpayers to resolve the long drawn litigation and close their disputes. Further, this scheme will work in a faceless manner and taxpayers may request for a personal hearing to present the case before the DRC.*

DID YOU KNOW?

- The Government had introduced provisions to file updated tax returns in the Finance Act, 2022.
- In this connection, the CBDT video Notification No. 48/2022 dated 29 April 2022 has inserted Rule 12AC in the Income Tax Rules, 1962. The Rule prescribes Form ITR-U ('the Form') for filing an updated return of income, for FY 2019-20 and subsequent FYs.
- The format of the Form has been provided in the aforesaid Notification; however the electronic utility of the Form is awaited.

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.

JMP Advisors Private Limited

12, Jolly Maker Chambers II, Nariman Point, Mumbai 400 021, India
T: +91 22 22041666, E: info@jmpadvisors.in, W: www.jmpadvisors.com

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