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 March 2025:

Income tax rulings

- **Non-refundable AMC fee received in advance held as being chargeable to tax in the year of receipt**

  - Johnson Lifts Private Limited[1]

The taxpayer is a manufacturer of lifts and engaged in providing lift maintenance services to its customers. The taxpayer received a total amount of INR 820 million for annual maintenance charges ('AMC') from its customers for the lifts installed by the taxpayer during the Financial Year ('FY') 2008-09. The AMC was shown as current liability since it was received in advance and services for the same were yet to be provided by the taxpayer.

The taxpayer's case was selected for scrutiny and the tax officer considered the advance AMC amount as income of the year of receipt since the agreement did not have any explicit clause for refund of the charges in case the contract was cancelled. On appeal, the Commissioner of Income tax (Appeals) ('CIT(A)') and the Chennai Tribunal allowed the matter in favour of the taxpayer.

On appeal by the Revenue, the Madras High Court ('HC') noted that the Companies Act, 1956 required that the financial statements of companies reflected a true and fair view. The return of income filed by the taxpayer is based on the financial statements prepared as per the requirements of the Companies Act, 1956. The Madras HC drew attention to the provisions of section 145(2) of the Act as applicable to the year under consideration, which require taxpayers to follow Accounting Standards ('AS') notified from time to time. The Madras HC relied on various rulings of the Supreme Court ('SC') and held that the tax officer could insist on a taxpayer to follow the appropriate method of accounting if the financial statements show a distorted financial position of the company. Further, the scope of total income as per section 5 of the Act shall include income which is received but also which is deemed to accrue or arise during the year.

The Madras HC then referred to Accounting Standard 9 'Revenue Recognition' which is concerned with the timing and method of revenue recognition. As per this Standard, only when uncertainties exist regarding the determination of amounts or its associated costs, these uncertainties may influence the timing of revenue. In the taxpayer's case, the taxpayer is not required to refund any amount to the customers and there is no uncertainty in the amount of AMC consideration derived for rendering of service.

[1] T.C.A.No.54 of 2025 & M.P.No. 1 of 2015

The Madras HC also referred to the SC decision in the case of J.K Industries Ltd[2] wherein it was held that if all the principles laid down in the Accounting Standards are followed by the taxpayer, the accounting income shall be considered as the taxable income of the taxpayer. The HC observed that this decision has made it clear that there is a paradigm shift from the 'Matching Principle' concept to the 'Fair Value' principle under Accounting Standards. The HC remarked that the Chennai Tribunal's observation that the taxpayer was bound to follow the Matching Principle of revenue and expenditure and was bound to provide future liability of maintenance from the advance collection made from customers was irrelevant in the present case and the Matching Principle is not an absolute principle invariably applicable to each case. The HC also agreed with the ruling of the Madras HC in the case of G.S.R. Krishnamurthy[3], relied upon by the Revenue.

The HC further referred to the Point of Taxation Rules, 2011 in context of Service Tax. As per the said Rules, the point of taxation is at the time when the invoice for services provided or agreed to be provided, is issued. Further, in a case where a person receives payment before the issuance of the invoice, the time when he receives the payment will be the point of taxation. Therefore, the taxpayer would have been liable to pay service tax on the advance AMC in the same quarter in which it was received.

Based on the above, the advance receipt of AMC fees was held to be taxable in the year of receipt.

JMP Insights – The Companies Act, 1956 as well as Companies Act, 2013 require all companies to follow the accrual basis of accounting. This ruling has not taken into account the concept of accrual as the services are yet to be rendered by the taxpayer and thus, no income had accrued even if it was received in advance. This ruling seems to have taken a divergent view from the Generally Accepted Accounting Principles, including the matching principle.

- **Rights to subscribe to shares held different from shares and held eligible for tax treaty relief**

- Vanguard Emerging Markets Stock Index Fund A Series of VISPLC[4]

The taxpayer is an Irish fund set up as a company and holds a valid Tax Residency Certificate ('TRC') of Ireland. It is registered as Foreign Portfolio Investor ('FPI') with the Securities and Exchange Board of India ('SEBI'). The taxpayer invests in the Indian Capital Markets in accordance with SEBI Regulations, earning income by way of dividend, interest and capital gain. During FY 2020-21, the taxpayer reported Short Term Capital Gains ('STCG') of INR 65,328,217 from the sale of rights entitlement and Short Term Capital Loss ('STCL') of INR 429,553,754 on the sale of other assets. The taxpayer claimed an exemption for the STCG earned from the sale of rights entitlement under Article 13(6) of

[2] 13 SCC 673 (2007)
[3] 262 ITR 393
[4] ITA No. 4657/Mum/2023

the Double Tax Avoidance Agreement ('DTAA') between India and Ireland and carried forward the STCL on the sale of the other assets.

The tax officer rejected the taxpayer's claim for exemption under the DTAA and set off the STCG against STCL. The tax officer was of the view that since the underlying asset of the rights entitlement was shares of the company, exemption under Article 13(6) of the DTAA cannot be availed. Article 13(6) is a residuary provision that capital gains earned by residents of Ireland on assets not covered in Article 13(1) to 13(5) will be taxed only in Ireland. On an application by the taxpayer to the Dispute Resolution Panel ('the DRP') against the order of the tax officer, the DRP confirmed the adjustment and also held that in view of the amendment made to Article 13(4) by the Multilateral Instrument ('MLI'), shares specified under Article 13(5) can be given a broader interpretation to include similar or comparable interest. The taxpayer filed an appeal with the Mumbai Tribunal in this regard.

On appeal, the Mumbai Tribunal ruled that the right to subscribe to any financial asset is distinct from the financial asset or shares. In arriving at this conclusion, the Tribunal examined the provisions of the Companies Act, 2013 and observed that a shareholder to whom an offer to subscribe to share has been made, may either accept or reject the officer or exercise the right to renounce the offer or transfer the right to another person. The Tribunal also noted that as per the SEBI Regulations on dematerialization of shares, a separate International Securities Identification Number ('ISIN') is allotted for rights entitlements.

The Tribunal relied on the decision of the SC in the case of Navin Jindal[5] wherein it was held that the right to subscribe to additional offer of shares/debentures on right basis, though embedded in the original shareholding is a distinct, independent and separate right, capable of being transferred independently of the existing shareholding.

The Tribunal further observed that under the Act as well, rights entitlement is considered distinct from shares which may be evidenced by the fact that as per section 2(42A) of the Act, the holding period in respect of right to subscribe to any financial asset is the date of offer till the date it is renounced in favour of another person. Similarly, as per section 55(2)(aa) of the Act, the cost of acquisition of such rights shall be NIL in case if they are renounced in another person's favour.

Further, the DTAA between India and Ireland was amended via the MLI to include other comparable interests in Article 13(4) and not Article 13(5), which deals with gains from the sale of shares. Therefore, it is evident that the two Contracting States intended to introduce other comparable interests only in Article 13(4) of the DTAA and not in Article 13(5), when amending the DTAA.

Based on the above, the Tribunal concluded that capital gains on rights entitlement would be covered by Article 13(6) and not Article 13(5) of the DTAA and that the taxpayer has correctly excluded the capital gain by applying the beneficial provisions of the DTAA and carried forward the loss as per the Act.

[5] 187 Taxmann 283 [2010]

JMP Insights *– This is a welcome ruling by the Tribunal wherein the Tribunal has distinguished the right entitlements from shares of a company and treated it as a separate asset.*

- **Mere fact of a director also being a shareholder in the company not a reason to consider bonus payments as dividends**

- Rohini Minerals Private Limited[6]

The taxpayer is a company engaged in the business of production and sale of poultry feeds. For FY 2017-18, the company had filed its Return of Income declaring total income of INR 187 million. During the relevant year, the taxpayer paid bonus of INR 125 million each to both of its directors and claimed the said amounts as deduction. During assessment, the tax officer disallowed the bonus paid to the directors under section 36(1)(ii) of the Act, on the basis that the bonus was paid in lieu of dividends to avoid payment of tax, since the directors were the only two shareholders and decision makers of the company. On appeal, the CIT(A) allowed the taxpayer's claim.

On further appeal by the Revenue to the Hyderabad Tribunal, the Tribunal noted that the bonus was in accordance with the Board Resolution ('BR'). The BR documented the decision of payment of bonus to the directors in addition to the existing remuneration, as well as the reasons for payment of the one time performance bonus. Further, the taxpayer had deducted appropriate withholding tax on the payment made to the directors and the directors paid tax at the Maximum Marginal Rate ('MMR') in their personal returns. The Tribunal therefore observed that there is no loss of revenue since tax would be payable by the taxpayer also at the MMR on its profits even if bonus was not paid. Therefore, there was no loss of tax revenue to the Government.

In addition, since the taxpayer was not covered by the Payment of Bonus Act, 1965, the maximum limit for bonus specified in the said Act would not be applicable. The Tribunal also noted that dividends are paid at an equal rate to all shareholders, based on their shareholding. However, the taxpayer has not followed any such proportion and paid an equal amount of bonus to the directors which is not linked to the shareholding of the directors in the company. Lastly, the Tribunal held that the tax officer failed to bring any evidence to prove that the payment was in lieu of dividends.

JMP Insights – This case highlights the importance of demonstrating the genuineness of bonus payments to directors, especially when they are also shareholders, alongside appropriate documentation.

On the point of tax neutrality, it appears that the Revenue did not highlight to the Tribunal that if the taxpayer had paid dividend and not bonus, there would have been an additional outflow for the taxpayer company by way of dividend distribution tax

[6] ITA No.980/Hyd/2024, 1079/Hyd/2024 & 1080/Hyd/2024

➢ Income tax demands raised after approval of resolution plan held to be invalid

- Jasrati Education Solutions Ltd. vs National Faceless Assessment Centre[7]

Jasrati Education Solutions Ltd. (formerly known as M/s. Educorp Infrastructure & Schools Management Ltd.) underwent Corporate Insolvency Resolution Process ('CIRP') under the Insolvency and Bankruptcy Code, 2016 ('the Code'). Following the commencement of these proceedings, the moratorium under the Code came into effect from 25 April 2018. Subsequently, the Resolution Plan was approved by the National Company Law Tribunal ('NCLT') on 14 December 2020. During this period, the tax officer initiated the assessment proceedings for FY 2017-18 in September 2019 and reassessment proceedings for FY 2012-13 and FY 2015-16 were initiated in March 2020. The assessments were completed in 2021, after the approval of the of the Resolution Plan by the NCLT. The taxpayer challenged these assessment orders before the CIT(A). However, the CIT(A) dismissed the appeals.

On further appeal, the Delhi Tribunal noted that the Resolution Plan, as approved by NCLT, assigned NIL value to income tax dues and declared that all pending proceedings related to periods before the approval date stood terminated, with no further liabilities enforceable. The Tribunal also noted that no tax claims were submitted during the CIRP.

The Tribunal placed reliance on the decision in the case of GAIL Mangalore Petrochemicals Ltd[8] wherein it had been held that all such claims which are not part of the Resolution Plan shall stand extinguished, and no person shall be entitled to initiate or continue any proceedings in respect of a claim which is not part of the Resolution Plan. The Tribunal also referred to Section 156A of the Act which requires the tax officer to revise demands in conformity with the Resolution Plan approved by the NCLT and issue a fresh demand notice.

Given that no claims of the income tax department were adjudicated during the CIRP and the Resolution Plan provided NIL value for tax dues, the Delhi Tribunal allowed the Taxpayer's appeals and quashed the reassessment orders for FY 2012-13 and 2015-16, along with the assessment order for FY 2017-18.

JMP Insights – This ruling is a well considered decision affirming the provisions relating to moratorium on tax proceedings and demands, which will be relevant to various companies undergoing insolvency proceedings.

[7] ITAs No.1147, 1149 & 1148/Del/2024
[8] 171 taxmann.com 17

CBDT Notification No. 21/2025 dated 25 March 2025

- **Scope of Safe Harbour Rules enhanced by the Central Board of Direct Taxes**

  To reduce litigation, enhance certainty in international transactions and promote ease of business for multinational groups, the Central Board of Direct Taxes ('CBDT') has amended the Safe Harbour Rules as under:

  - The definition of "core auto components" has been expanded and now includes lithium-ion batteries used in electric and hybrid electric vehicles.

  - The threshold of turnover has been increased to INR 300 crore (from INR 200 crore) for eligible businesses offering software development, IT-enabled services, knowledge process outsourcing, software-related R&D and generic pharmaceutical R&D.

  - The applicability of the Safe Harbour Rules has been extended to Financial Years 2024-25 and 2025-26.

Press release relating to clarification on the application of the Principal Purpose Test

- The CBDT had issued the Circular No. 01/2025 dated 21 January 2025 ('the Circular') to provide guidance on the application of the Principal Purpose Test ('PPT') in DTAAs.

- The CBDT has now issued a clarification on the above Circular vide a Press Release dated 15 March 2025 with the intent to ensure consistency in the interpretation of the tax law.

- The Press Release clarifies that the Circular shall apply to the PPT provisions in only those DTAAs where the PPT provisions are present. Further, the Circular does not intend to interfere or interact with any other treaty provisions, including those cited to determine DTAA entitlement or denial of DTAA benefits, other than the PPT clause.

- The Circular does not intend to interfere or interact with the anti-abuse rules under the Act such as the General Anti-Abuse Rules ('GAAR'), Specific Anti-Abuse Rules ('SAAR') and Judicial Anti-Abuse Rules ('JAAR') resulting from judicial interpretations.

- The Circular does not introduce any new legal interpretation and reaffirms that it applies only to the PPT provisions without any impact on the other provisions of the Act.

Abolition of Equalisation Levy on certain online advertising services

- The Equalisation Levy ('EL') was initially introduced in the Finance Act, 2016 on certain online advertising services provided by non-residents to residents. The scope was subsequently expanded with effect from 1 April 2020 to levy EL on certain e-commerce supplies or services. EL on e-commerce supplies or services was abolished with effect from 1 August 2024.

- EL applicable to online advertising services has also been abolished with effect from 1 April 2025.

FCRA Notification Tightens Prior Permission Regime

- The Ministry of Home Affairs has notified[9] revised timeframes for the validity of prior approval under the Foreign Contribution (Regulation) Act, 2010 ('FCRA').

- These new rules limit the period for accepting foreign donations to 3 years in case of receipt of a prior permission granted u/s 11(2) of the FCRA and for spending them to 4 years. This is a significant shift from the previous system that had no fixed end date.

- This alteration means NGOs and charities will face tighter rules, requiring more detailed funding plans and alignment of project timelines and quicker use of funds.

DID YOU KNOW?

The CBDT has published Frequently Asked Questions ('FAQs') on the guidelines concerning the Compounding of Offences under the Income Tax Act, 1961.

These guidelines supersede all earlier directives on the matter and are effective for all pending and future applications for compounding of the offences, from the date of issuance.

The FAQs offer clarifications on several key aspects of the guidelines, such as the meaning of compounding, competent authority and jurisdiction, application process and associated fees, and the conditions for compounding.

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.

[9] No.11/21022/36(0025)/2025/FCRA-II

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