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 June 2025:

Income tax rulings

- **One-time voluntary payment relating to the Employee Stock Options Plan by the employer is a capital receipt**

  - Manjeet Singh Chawla vs Deputy Commissioner of TDS[1]

The taxpayer is an ex-employee of Flipkart Internet Private Limited ('FIPL'), a wholly owned subsidiary of Flipkart Marketplace Private Limited ('FMPL'). FMPL is the wholly owned subsidiary of Flipkart Private Limited, Singapore ('FPS'). During the term of his employment, FPS had rolled out a Stock Option Plan called Flipkart Stock Option Plan ('FSOP'), wherein FPS granted certain stock options to eligible persons, including employees of its subsidiaries. As per the FSOP, the taxpayer was granted stock options with a vesting period of 4 years. Due to the announcement of the disinvestment of one of its wholly owned subsidiaries, PhonePe, there was a decline in the value of these stock options. Due to such decline, FPS announced a one-time compensation to cover the loss in the value of the stock options held on a specified date.

The taxpayer filed an application under Section 197 of the Income Tax Act, 1961 ('the Act') seeking a NIL withholding certificate for deduction of tax at source by FPS. Such application of the taxpayer was rejected by the tax officer. The taxpayer submitted that the payment from FPS does not constitute income under Section 2(24) of the Act and the same was a capital receipt which did not contain any element of income and hence was not chargeable to tax.

The tax officer stated that FSOP related benefits are inherently income, taxable as perquisites, and thus, compensation for lost FSOPs should be taxed in the same manner.

Aggrieved by the tax officer's order, the taxpayer filed a writ petition before the Karnataka High Court ('HC').

The Karnataka HC relied on the decision of the Delhi HC in the case of Sanjay Baweja[2] due to identical facts. It also noted that this decision has not been challenged by the Revenue and thus has attained finality. The Karnataka HC observed certain anomalies/errors in the decision of Madras HC ruling in the case of Nishithkumar Mukeshkumar Mehta[3] and rejected

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[1] WRIT PETITION NO. 20212 OF 2023 (T-IT) (Karnataka HC)
[2] W.P.(C) 11155/2023 (Delhi HC)
[3] W.P.No.26506 of 2023 (Madras HC)

Revenue's reliance on this decision. The Karnataka HC further noted that this judgment is under challenge and has not attained finality.

The HC, relying on the various judgements, held as under:

- Withholding tax cannot be deducted if the payment does not constitute income in the hands of the payee.

- The compensation for fall in value of the stock options (profit making structure of the taxpayer) was a one-time voluntary payment.

- The difference between market value of the allotted shares and the exercise price are taxed as perquisite when options are exercised. Since the taxpayer had not even exercised his options and shares were also not allotted, the value of such options was not determinable. Therefore, without the actual allotment of shares, it is not possible to calculate the value of the perquisite. Accordingly, it is impossible to tax this compensation as salary or perquisite.

- Sections 45 and 48 of the Act are an integrated code. Since options are not exercised, the cost of acquisition of such stock options cannot be determined. Thus, the computation mechanism fails and consequently Section 45 cannot be applied.

- A capital receipt i.e. compensatory payment which is not chargeable under Section 45 of the Act cannot be brought to tax under any other head, not even under Income from Other Sources.

- ESOPs are taxable at two stages i.e. on exercise and sale of allotted shares. In the present case, only the vesting of FSOP has taken place. This compensation was made by FPS without any corresponding contractual obligation and considering that the number of FSOP remains the same, compensation cannot be said to constitute a revenue receipt.

JMP Insights –*This ruling clarifies that the determination of income tax liability hinges on the characterization of the amount in the hands of the recipient, rather than the perspective or intention of the payer. Furthermore, the ruling underscores the significance of the surrounding circumstances such as the timing and context of the receipt in accurately determining its character. These factors are critical in ascertaining the correct tax treatment and ensuring that the substance of the transaction prevails over its form.*

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- **Mutual Fund Promotion and Initial Public Offer Expenditure by Asset Management Company allowed as tax deduction**

  - Commissioner of Income Tax vs Sahara Asset Management Company Pvt. Ltd.[4]

The taxpayer is an asset management company, acting as a fund manager and managing various mutual fund schemes. The taxpayer claimed deductions for expenses incurred on mutual fund promotion and for launching an initial public offer ('IPO').

The tax officer disallowed these expenses, arguing that as a fund manager, the taxpayer need not have incurred such costs. The tax officer's stance was that such expenses did not serve the direct business interests of the taxpayer and therefore could not be considered as incurred wholly and exclusively for the purpose of its own business.

The Madras HC observed that the tax officer is not entitled to put himself in the shoes of the taxpayer and assume the role to decide whether to incur the expenses and how much is a reasonable expenditure, having regard to the circumstances of the case. The Madras HC relied on the Bombay HC in the case of Mahindra and Mahindra Ltd. vs. Commissioner of Income Tax[5] wherein it was held that expenses incurred by an entity on behalf of a group entity for reasons of commercial expediency should be considered as incurred for business purposes. These expenses are directly related to the taxpayer's business and therefore eligible for deduction.

The HC observed that the mutual fund promotion and IPO expenditures were incurred in the ordinary course of business and were directly related to the taxpayer's commercial interests. The HC held that the tax officer cannot substitute his own business judgment for that of the taxpayer and that the test of commercial expediency must be applied in a practical and business-like manner.

JMP Insights –*The decision provides clarity and support for asset management companies and similar entities in claiming deductions for promotional and IPO related expenses. It reiterates the principle that business expenditure incurred for commercial expediency in the course of business is deductible, regardless of incidental benefits to other entities.*

- **Conversion of Company into LLP regarded as transfer if stipulated conditions are not satisfied; however, transfer at book value would not result in any capital gains**

  - ISC Specialty Chemicals LLP vs Income Tax Officer[6]

The taxpayer ('LLP') was registered upon conversion from a private limited company as per the Limited Liability Partnership Act, 2008 ('the LLP Act').

As a result of this conversion, the entire undertaking including all tangible movable and immovable and intangible assets, rights, interests, privileges, liabilities and obligations was

[4] Tax Case Appeal No.761 of 2010
[5] [2023] 151 taxmann.com 332 (Bombay)
[6] ITA No. 457/Mum/2025

transferred to and vested in the taxpayer. All the assets and liabilities were recorded at book value by the taxpayer upon conversion. The taxpayer contended that the conversion did not constitute a 'transfer' under the Act, and therefore, no capital gains tax was leviable. However, the tax officer treated such conversion as a taxable transfer, as all the conditions prescribed under the Act to claim tax neutrality upon conversion were not satisfied.

The taxpayer contended before the Tribunal that as no consideration was received by the predecessor company at the time of conversion, the computation mechanism for determining capital gains under the Act failed, rendering the charging provisions unworkable.

The Tribunal held that conversion of a private company into LLP constitutes a 'transfer' for capital gains tax purposes, aligning with its earlier ruling in the case of Clerity Power LLP[7]. In this ruling, the Tribunal had stated that the Bombay HC ruling of Texspin Engg. & Mfg. Works[8] could be differentiated on its specific facts. It observed that conversion of company to an LLP is different as compared to succession of partnership firm to a company under Part IX of the Companies Act, 1956. It further observed that the definition of 'convert' in the LLP Act defines such conversion to mean the transfer of assets and property of the company to the LLP.

The Tribunal referred to the Memorandum to the Finance Bill, 2010 and held that section 47(xiiib) of the Act was introduced to treat the conversion of company into an LLP as tax neutral, subject to fulfilment of the prescribed conditions. In the absence of fulfilment of all the conditions, the legislative intention has always been to treat such conversion as a taxable transfer.

The Tribunal stated that the capital gains computation under Section 48 of the Act must be read in conjunction with the charging provisions of Section 45 of the Act. The Tribunal held that if the difference between the transfer value and the cost of acquisition was Nil, no capital gains arose as a result of the transfer.

JMP Insights –*This ruling highlights that while the conversion of a company into an LLP is considered a 'transfer' for tax purposes, exemption from capital gains tax under section 47(xiiib) of the Act is contingent upon strict adherence to all specified conditions. The taxpayers are entitled to deduct the cost of acquiring the transferred assets when calculating capital gains.*

This ruling specifically addresses the tax implications for the company itself during the conversion to an LLP. The taxation for the shareholders of the company in such situation was not a matter before the Tribunal, remains an open question.

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[7] ITA No. 3637/Mum/2015

[8] [2003] 263 ITR 345 (BOM)

- **Allowance of setoff of business Loss of a Permanent Establishment against ECB Interest income**

  - Abu Dhabi Commercial Bank PJSC vs DCIT (International Taxation)[9]

The taxpayer is a UAE tax resident having two branches in India which constitute its Permanent Establishment ('PE') in India. The taxpayer earned interest income from External Commercial Borrowings ('ECB') provided directly to Indian customers without any involvement of its Indian PE. This ECB interest income was declared as Income from Other Sources and offered to tax at a concessional tax rate of 5% under Article 11(2) of the India-UAE DTAA ('DTAA'). The taxpayer also claimed set off of business losses incurred by its Indian PE against the ECB interest income and offered the balance income at 5% DTAA rate.

The tax officer challenged this set-off, arguing that once interest income is taxable on a 'gross basis' as per Article 11(2) of the DTAA, no further deductions, including the set-off of losses, are permissible. The tax officer relied on CBDT circular[10] and the Vienna Convention and contended that the term 'gross interest' implies taxation of the entire amount without any deduction for expenses or losses.

The Tribunal referred to the OECD Model Tax Convention on Income and Capital 2017, which defines 'gross income' as the amount regardless of expenses incurred to earn such interest. The Tribunal further held that Article 11(2) of the DTAA requires initial computation of interest income as per the domestic law, including set-off provisions, before applying the concessional tax rate. As the taxpayer had not claimed any deduction for expenditure, its computation of income did not violate the conditions of Article 11(2)(a) of the DTAA.

JMP Insights –*The Tribunal ruling in this case firmly establishes that non-resident entity can set off current year losses incurred its Indian PE against Income from Other Sources.*

- **Refund of Dividend Distribution Tax on dividends paid to International Finance Corporation**

  - Polycab India Limited vs Assistant Commissioner of Income tax[11]

The taxpayer is a publicly listed company and International Finance Corporation ('IFC') was one of the shareholders of the taxpayer. IFC, established in 1956, is a global development institution under the World Bank group, with India being a signatory to its founding agreement and a subscriber to its share capital. The taxpayer paid Dividend Distribution Tax ('DDT') on the dividends distributed to all shareholders. The taxpayer sought a refund of the DDT paid on the portion of dividends distributed to IFC, citing the immunity granted to IFC under the IFC Act, 1958 ('IFC Act').

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[9] ITA No. 3404/Mum/2023
[10] Circular No.333 dated 2 April 1982
[11] ITA No. 4671 & 4672/Mum/2023

The tax officer rejected refund application stating that DDT is an additional charge to tax on the company's profits. It is not on the shareholder's income and thus the shareholder's tax status is irrelevant.

The Tribunal while ruling emphasised that the IFC Act, has an overriding effect on all existing laws in India, including the Act even though the latter was enacted later. Section 9 of Article VI of the IFC Act provides IFC with immunity from all applicable taxation on its assets, property, income, operations and transactions.The Tribunal noted that when there is an agreement between sovereign countries which is codified as an Act of Parliament that income of such institutions is exempted from tax then, there need not be any specific provisions in the Act to exempt any income. The Tribunal held that IFC's equity investment constitutes a transaction within the scope of the IFC Act and therefore, any payment or distribution, such as dividends made to IFC falls within the ambit of the immunity conferred by the IFC Act. The Tribunal held that section 115-O(1A) (ii) of the Act specifically mandates that dividends paid to the New Pension System (‘NPS’) Trust, which is exempt from taxation must be deducted from the total amount of dividends distributed for the purposes of computing DDT. By using parity of reasoning and equitable statutory construction, the Tribunal concluded that IFC's revenue should be treated equally with income of the NPS Trust as it is also exempt from taxation under an overriding statute.

JMP Insights – *This ruling may be the subject matter of debate since DDT is an additional tax levy on the profits of the company and not on the shareholders. Although the IFC Act exempts the income of an IFC from taxation, this immunity does not extend to the company distributing such income which remains liable to pay DDT.*

Further, the rationale for exempting DDT is explicitly grounded in provisions related to the NPS, where such a deduction is explicitly permitted in the DDT computation. In contrast, there is no analogous exclusion stipulated with respect to IFC.

DID YOU KNOW?

The Union Cabinet has approved the Employment Linked Incentive (‘ELI’) Scheme to support employment generation, enhance employability and social security across all sectors, with a special focus on manufacturing. It offers incentives to first-time employees and provides support to employers for generating additional employment.

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 has been recently awarded as Tax Advisory Expert of the Year in India – 2025 by 2025 Lawyer Network Annual Awards for its outstanding services. We are proud to receive this accolade and endeavor to continue providing high quality services to our clients!

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JMP Advisors offers advice in international taxation, domestic taxation, transfer pricing, mergers and acquisitions, Goods and Services Tax (GST), business laws and exchange control regulations and foreign investment consulting. We specialize in fiscal strategy, policy foresight and advocacy matters and are trusted advisors to high net worth families. Our team at JMP Advisors takes pride in being the best at what matters most to clients - technical expertise, innovative solutions, consistent, high quality service, reliability and ease of doing business.

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