# 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 December 2020:

## *Income tax rulings*

### ➢ Voluntariness is an important element of "gift"

- Redington (India) Limited (Madras HC) (T.C.A.Nos.590 & 591 of 2019)

The Madras High Court ('HC') has observed that the word "gift" has not been used either in the Board resolution or in the transfer deed to record the transfer of entire shareholding of the Indian taxpayer in its Dubai subsidiary to another newly set up subsidiary in Cayman Islands, without any consideration. The HC held that a gift should satisfy the conditions prescribed in section 122 of the Transfer of Property Act, which defines gift as transfer of property without any consideration and which is made voluntarily. A Gift deed executed with free and voluntary consent is one example of "voluntariness". In the given case, mental intention and physical execution of the gift are absent.

The HC has further observed that the acquisition of 27% stake by a private equity fund in the Cayman Islands subsidiary within a short span of time after the share transfer to the said subsidiary demonstrates that the subsidiaries were established as mere conduits to avoid taxation in India and the entire transaction was executed to restructure the business for obtaining tax benefits, without any intention of making a gift. The HC, therefore, ruled that the transaction results in capital gains for the Indian company. The HC also upheld the application of the CUP Method to determine the arm's length price for the transfer of shares.

***JMP Insights:*** *Tax relief for a gift may not be available in cases where the transfer is executed for a tax benefit. Further, it is important that all transfers, including gifts, are backed by appropriate documentation to substantiate the underlying intent. Making a gift without adequate documentation, especially to a company in a tax haven like Cayman Islands is more likely to be viewed as being done for tax benefit, rather than as a gift. Going forward, these types of transactions would also be subject to General Anti Avoidance Rules ('GAAR').*

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## ➢ Discretionary trust taxable as individual for voluntary contribution received from the group companies

- Shriram Ownership Trust v. CIT (Madras HC) (TCA No. 242 of 2018)

The Madras HC has set aside the order of the Income tax Appellate Tribunal ('ITAT') and rejected the contention of the taxpayer to be considered as an Association of Persons ('AOP') rather than as an individual. The taxpayer filed the Return of income in the capacity of a trust based on the Explanation to Section 2(31) of the Income-tax Act, 1961 ('the Act') clarifying that an AOP / Body of individuals shall be deemed to be a person whether or not such person was established with the object of deriving income, which allows the taxpayer to be treated as an AOP. The HC has held the private discretionary trust as a representative assessee in the capacity of individual and taxed the voluntary contribution received from six group entities as income liable to tax.

While rendering this judgement, the Madras HC has relied on the Supreme Court ('SC') ruling in the case of Indira Balkrishna (39 ITR 546) and held that the beneficiaries did not come together with a common purpose, which is a prerequisite for formation of an AOP and beneficiaries also played no role in the operation of the taxpayer. It was also held that a trustee appointed under a trust has to be treated as a representative assessee in terms of section 160 of the Act, provided he receives or he is entitled to receive any money on behalf of or for benefit of any person and that income is to treated in the like manner to the same extent as it would be taxed in the hands of the beneficiaries.

The HC has also dealt with the taxpayer's plea that the Joint Commissioner of Income Tax ('JCIT') does not have jurisdiction to issue any directions to the tax officer since the scrutiny was a limited scrutiny and all the issues originally completed were not open to scrutiny. The HC has held that the taxpayer is precluded from raising this issue since it has not filed any appeal against the order of the ITAT and since substantial questions of law were already framed, no additional questions can be considered by the HC unless these are raised by the tax department.

***JMP Insights*** *– The Madras HC has dealt with the issue whether the taxpayer, who has not filed an appeal to the High Court can raise any legal issue / objection before the High Court to substantiate its position in the Departmental appeal. This issue requires detailed consideration in order to understand its ramifications in pending litigation matters.*

## ➢ Notional rent not taxable in case of a building which is let out before receipt of Occupancy certificate

- Brigade Enterprises Ltd v. Addtl. CIT (Karnataka HC) (ITA No. 528 of 2015)

The Karnataka HC has reversed the order of the ITAT upholding taxation of notional rent from a partially completed building, which was let out even before the Occupancy certificate was received from the municipal authorities.

In the present case, the taxpayer was engaged in the business of construction and sale of residential/ commercial buildings. The taxpayer had let out a part of a partially constructed building and offered notional income from house property at 50% of the annual letting value, despite no income being earned in the relevant year.

While rendering this judgement, the Karnataka HC has relied on municipal byelaws wherein it is was not permissible to occupy a building until it receives occupancy certificate. Therefore, it was concluded that notional rent cannot be taxed in case of an under construction building since the building would legally come into existence only on issuance of the Occupancy certificate.

## ➢ Charitable trust status of Tata Trusts upheld

- Sir Dorabji Tata Trust (Mumbai ITAT) (ITA No. 3909/Mum/2019)

In the given case, the Commissioner of Income tax ('CIT') had passed a revision order under section 263 of the Act on the grounds that the assessment order passed by the tax officer was erroneous and prejudicial to the interest of the Revenue. The CIT had pointed out that the tax officer did not adequately enquire into certain matters relating to remuneration paid to managing trustee, investments and controlling structure of the trust.

The Mumbai ITAT has rejected the revision order passed by the CIT denying charitable status of Tata Trusts stating that the rejection is largely dependent on the fact that the CIT believes that the tax officer has not made enough enquiry into certain facts. The ITAT has observed that the provisions of section 263 do not endorse "unfettered discretion" of the CIT. The role of the tax officer is similar to that of an auditor to a certain extent. Accordingly, a tax officer may choose to enquire into matters if there are doubts on the correctness of the claim and not all matters are enquired into in detail.

Regarding remuneration paid to managing trustees, the ITAT has observed that the payment was made in accordance with the trust deed and merely since the amount was high, it cannot be considered as a case to make further inquiry about its reasonableness.

As regards investments made in Tata Group of companies, the ITAT has noted that the tax officer did not dig deeper into the investments since the investments were accepted as valid for more than four decades. There was no occasion for the tax officer to re-examine the investments and this cannot be considered as being prejudicial to the interests of the revenue.

The ITAT ruled that section 263 cannot be invoked merely on the basis of an opinion that the enquiry was inadequate and accordingly, the charitable trust status was upheld.

***JMP Insights:*** *Section 263 has been enacted to arm the CIT with the power of revising any order of the tax officer, where the order is erroneous and the error has resulted in prejudice to the interests of the Revenue. In this case, the ITAT has reiterated the principle of law that an assessment order cannot be considered as erroneous on the ground that a*

*deeper enquiry ought to have been made or proper exercise ws not done while making the assessment. The fact as to whether the tax officer has applied his mind or not need not necessarily be determined from what has been stated in the assessment order alone, it has to be examined as to whether any inquiry was at all conducted by the tax officer. There exists a difference between 'lack of enquiry' and 'inadequate enquiry'. If there was any enquiry, even inadequate, that would not give an occasion to exercise jurisdiction under section 263 of the Act.*

## ➢ Shares transferred as a valid gift does not give rise to taxable income

- Manjula Finance Ltd. (Delhi ITAT) (ITA No. 3727/Del/2018)

The ITAT has ruled that the shares, which held as stock in trade by the taxpayer and gifted to its group companies as part of a family arrangement, would not be taxable in the hands of the donor. The ITAT has observed that all the elements of a valid gift are satisfied in this case such as the taxpayer being the sole owner of the shares having a full right to gif the shares, relevant amendments were made to the Articles of Association to provide for making a gift and necessary resolutions were passed to give shares as a gift and for acceptance of the gifts. Further, only real income can be taxed in the hands of a taxpayer and not hypothetical income. It has also been clarified that the given case pertains to a period prior to the introduction of GAAR provisions and accordingly, the principles laid down therein cannot be applied to the present case.

***JMP Insights**: This ruling has come just a few days subsequent to the Madras HC ruling in the case of Redington (India) Ltd. (supra) where the HC has after examining the facts and sequence of various events surrounding the gift of shares concluded that the transfer of shares without consideration was a part of group restructuring to avail tax benefits and hence, considered to be in the nature of capital gains.*

## ➢ FTS taxable in the year of receipt as per the provisions of India - Germany DTAA

- ABB AG (Bangalore ITAT) [IT(IT)A No.1444/Bang/2019]

The Bangalore ITAT has allowed the claim of the taxpayer, a German company, of offering the income from Fees for Technical Services ('FTS') on a receipt basis. The taxpayer had earned FTS during the year. However, it had not raised any invoice and the Indian payer had accounted the said amount as a provision in its books of account.

In rendering its judgment, the ITAT has appreciated that the provisions of the DTAA prevail over those of the Act and held that while section 5 of the Act taxes income of a non-resident if it accrues or arises in India, it is important to also analyse the articles of the DTAA. As per the provisions of the India – Germany DTAA with regard to FTS, the ITAT has observed that the incidence of tax is on a "payment" or a "remittance" in the nature of FTS. Since the provisions of the DTAA prevail over those of the Act, the FTS earned by the taxpayer cannot be taxed on an accrual basis.

***JMP Insights**: There is a vast difference between the method of accounting as laid down under section 145 of the Act and the incidence of tax on income as laid down in this judgement under the DTAA. The charge on income accruing or received in India, imposed by section 5 of the Act, cannot be avoided by any method of accounting. This proposition is of particular significance in the case of non-residents, who might be assessable in respect of stray items of income accruing or received in India. The chargeability of income received in India cannot be escaped by a non-resident on the ground that the regular method of accounting followed by the non-resident is the mercantile system, nor can the chargeability of income accruing in India be escaped on the ground that the non-resident maintains accounts on the cash system. However, this judgement is a welcome move since it provides clarity on the timing of taxability of FTS.*

## ➢ Gains from frequently traded shares characterised as business income

- Sunilkumar Somitra Singh Dangi (Surat ITAT) (ITA No.3311/AHD/2015)

The Surat ITAT has ruled that income from frequently traded shares is to be treated as business income since the holding period of the shares was longer than 30 days and less than a year and in some cases, the holding period was lower than 30 days as well. In rendering its decision, the ITAT has observed that the taxapyer's activity of regularly buying and selling shares is for the purpose of earning profits rather than for holding as an investment for a longer duration. The ITAT has further observed that the taxpayer has substantially higher short term gains as compared to long term gains. The amount of dividend was also nominal as compared to the short term capital gains.

***JMP Insights**: The issue whether income from sale of shares would be taxed as business income or capital gains has been a contentious issue for long and there are several conflicting decisions based on the facts of each case. The CBDT has already provided various tests which are to be examined in order to characterise the nature of income from sale of securities by issuing circulars on this issue.*

## ➢ Subscription fee taxable as business income; not royalty as per India – Netherlands DTAA

- Elsevier BV (AAR No. 1481 of 2013)

The Authority for Advance Rulings ('AAR') has observed that subscription fee paid for accessing an existing database of scientific books and journals containing research material and solutions is subject to limited rights and the said fee is not royalty as defined under Article 12 of the India – Netherlands DTAA. The transaction in effect is similar to purchase of books or journals in electric format. Since the copyright of the material is not transferred and the material is available only for reading in an arranged and categorised format, it does not fall within the definition of royalty.

The AAR has further explained that printing or accessing the database does not tantamount to use of scientific work. It only reflects printing of an ebook for self use. The

copyright of the scientific work was not transferred; only the permission to print the material for self use was granted. Therefore, it has been concluded that payment of subscription fee cannot be termed as royalty and would be considered as business income.

***JMP Insights**: The AAR, while relying on OECD commentary, explains in detail the difference between transfer of copyright of scientific work and the transfer of scientific material for self use with restrictions of reproduction. It is important to analyse the views discussed in the OECD commentary and India's position on these views in order to appropriately classify the payment as royalty or business income.*

## *Decision of the Permanent Court of Arbitration, Hague*

### ➢ Cairn Energy Plc wins international arbitration case against the Indian Government in a tax and investment related dispute

Cairn Energy Plc ('Cairn Energy') has won the arbitration against the Indian Government over a tax dispute arising from a demand of ~INR 103 billion (~USD 1.3 billion) on listing of its Indian operations in 2007.

Cairn Energy had been served a tax notice in 2014 over the transfer of shares of Cairn India to Cairn UK Holdings as part of an internal group restructuring undertaken by it in 2006 while gearing up for the Initial Public Offer of Cairn India. The Delhi Tribunal had held that Cairn UK Holdings, a wholly owned subsidiary of Cairn Energy, had earned capital gains of over INR 245 billion (~ USD 3.3 billion) before the public listing of Cairn India. Cairn Energy contested the decision of the Delhi Tribunal and presented its case for international arbitration.

The Permanent Court of Arbitration at Hague has maintained that the Cairn tax issue is not a tax dispute but a tax-related investment dispute and, hence, it falls under its jurisdiction. The Hague Tribunal has ruled that India's demand for past taxes was a breach of fair treatment under the UK-India Bilateral Investment Treaties ('BIT') and has awarded damages of USD 1.2 billion plus interest and costs.

It is anticipated that the Indian Government will be studying the award in the arbitration case in all its aspects carefully in consultation with its counsels to determine the further course of action.

This development comes close on the heels of Vodafone winning a separate arbitration on retrospective amendment of the tax law. Consequently, India has challenged the arbitral award before the Singapore Court, which has ruled that the tax demand from Vodafone based on a retrospective legislation was in the breach of the guarantee of fair and equitable treatment guaranteed under India-Netherlands BIT.

## *Notifications and Circulars*

### ➢ Extension of time limits for various direct and indirect tax compliances

Direct tax

In view of the continued challenges faced by taxpayers in completing statutory compliances owing to the COVID-19 pandemic and the ensuing lockdown, the Government has extended the due dates for various compliances for third time by issuing the Press Release dated 30 December 2020.

| Nature of compliance | Original due date | Due date after previous extension | Revised due date |
|---|---|---|---|
| Filing of Income Tax Return (ITR) where the taxpayer is required to furnish a report of Transfer Pricing (TP) Audit in Form No. 3CEB | 30 Nov 2020 | 31 Jan 2021 | 15 Feb 2021 |
| Filing of ITR by a company which is not required to furnish TP Audit Report | 31 Oct 2020 | 31 Jan 2021 | 15 Feb 2021 |
| Filing of ITR by a taxpayer, who is required to get its accounts audited under the Act or under any other law | 31 Oct 2020 | 31 Jan 2021 | 15 Feb 2021 |
| Filing of ITR by a taxpayer, who is a partner in a firm which is required to get its accounts audited | 31 Oct 2020 | 31 Jan 2021 | 15 Feb 2021 |
| Filing of ITR in any other case | 31 July 2020 | 31 Dec 2020 | 10 Jan 2021 |
| Filing Tax Audit Report for FY 2019-20 (AY 2020-21) | 30 Sep 2020 | 31 Dec 2020 | 15 Jan 2021 |
| Filing TP Audit Report for FY 2019-20 (AY 2020-21) | 31 Oct 2020 | 31 Dec 2020 | 15 Jan 2021 |
| Filing the declaration to opt for Vivad Se Vishwas Scheme | 31 Mar 2020 | 31 Dec 2020 | 31 Jan 2021 |

Indirect tax

Due date for furnishing the annual GST return for FY 2019-20 has been extended from 31 December 2020 to 28 February 2021.

## ➢ Quoting of Unique Document Identification Number ('UDIN') in Audit reports and certificates issued by Chartered Accountants

The Central Board of Direct Taxes ('CBDT') had, vide Press Release dated 26 November 2020 intimated that ICAI generated UDIN for uploading Tax Audit Report would be validated by CBDT in an effort to weed out fake/ incorrect Tax Audit Reports.

The IT department has now released FAQs on quoting UDIN in Audit reports and certificates issued by CAs. It has been clarified that uploading documents without generating UDIN is permissible. However, in that case, UDIN should be updated within 15 calendar days of uploading the relevant document, to avoid the said document being treated as invalid.

The FAQs set out the procedure for correction of errors in a document where UDIN has already been updated and also clarify the impact of revoking UDIN after the document is accepted by the taxpayer on the ICAI portal.

***JMP Insights*** *–The ICAI in 2019 made generation of UDIN from the ICAI website mandatory for all certificates, tax audit reports and other attestations by members as required by various regulators. This is a welcome measure taken by ICAI in order to curb fraudulent certifications and forgery.*

**DID YOU KNOW?**

The Income Tax department has introduced a new initiative called, 'Jhatpat Processing' for ITR 1 and ITR 4 to smoothen the ITR filing experience for taxpayers. This initiative goes with the tagline **"File Karo Jhat Se, Processing Hogi Pat Se"**. The 'Jhatpat Processing' feature is intended to allow taxpayers to file returns easily and to ensure that these are processed by the tax department in a timely manner.

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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