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 2021:

Income tax rulings

- **Assessment order passed u/s 143(3A) of the Income-tax Act, 1961 after 1 April 2021 is bad in law**

  - Gurgaon Realtech Limited (Delhi HC) [W.P.(C) 5849/2021 and CM No.18315/18316 and 18317 of 2021].

The taxpayer had filed a writ petition against the assessment order dated 15 April 2021 passed under section 143(3) of the Income-tax Act, 1961 ('the Act') read with section 143(3A) and 143(3B) of the Act. The taxpayer had simultaneously filed an appeal with the Commissioner of Income Tax (Appeals) ('CIT(A)') against the impugned assessment order to ensure that the time period to file the appeal is not crossed before challenging the validity of the assessment order by a writ petition.

The Hon'ble Delhi High Court ('HC') accepted the submission on maintainability of the writ petition despite the fact that an appeal was already preferred before the CIT(A) on the grounds that the impugned assessment order, being without jurisdiction, is non-est in the eyes of law.

It was held that assessment order passed after 31 March 2021 should be in consonance with new provisions of faceless assessment. Reliance was placed by the HC on the provisions of Section 143(3D) of the Act and Central Board of Direct Taxes ('CBDT') Notification dated 31 March, 2021 while passing the order. The impugned assessment order was set aside by HC and the Tax Department was granted the liberty to proceed with the assessment process as per the new provisions of faceless assessment.

- **Morgan Stanley's income from Indian Depository Receipts is exempt under Article 22 of India - Mauritius Double Tax Avoidance Agreement**

  - Morgan Stanley Mauritius Co Ltd (Mumbai ITAT) [ITA No.: 7388/Mum/19].

The taxpayer is a company incorporated and fiscally domiciled in Mauritius and a tax resident of Mauritius. The taxpayer had invested in the India Depository Receipts ('IDRs') by Standard Chartered India, ('SCB-India') with the underlying asset in the form of shares in Standard Chartered Bank, UK ('SCB-UK') held by the depository's custodian, i.e., BNY-US. The taxpayer had received a certain sum from SCB-India, in respect of dividends for the underlying shares relatable to the IDRs in which the taxpayer had invested. The tax officer considered this dividend income as taxable in the hands of the taxpayer.

The Income Tax Appellate Tribunal ('ITAT') held that the dividend was taxable in India as per section 9(1)(i) of the Act. However, the ITAT granted relief under Article 22 of the India-Mauritius Double Tax Avoidance Agreement ('DTAA'). The ITAT observed that none of the payments could be treated as being made by an Indian resident, irrespective of whether the payer was considered to be SCB-UK or SCB-India, since the former was a company incorporated in, and fiscally domiciled in the UK and the latter, an Indian branch office and Permanent Establishment ('PE') of a company, incorporated or fiscally domiciled in the UK. The ITAT further observed that the taxpayer's income was not covered within the ambit of dividends under Article 10 of India-Mauritius DTAA since the dividends were not paid by an Indian company to a Mauritian tax resident (i.e. dividend paid by a company which is a resident of a Contracting State to the resident of the other Contracting State) which was a pre-condition for the applicability of Article 10 of the DTAA. Since no other provisions of the DTAA could cover the taxpayer's income the ITAT allowed the appeal and held the taxpayer's income to be treaty-protected inasmuch as it could not be taxed in the hands of the taxpayer in India, by virtue of Article 22(1) of India-Mauritius DTAA.

***JMP Insights**: This ruling establishes that an IDR holder is not simply a shareholder though entitled to the benefits of the shareholding. Further, although the derivative securities derive their value and benefits from the underlying assets abroad, the dividend income from the IDRs would still be taxable under the provisions of the Act where the income accrues through or from a business connection in India, subject to relief, if any, under the DTAA.*

- **Write-off of investment in loss making overseas subsidiaries is allowed as business loss**

  - Maneesh Pharmaceuticals Ltd (Mumbai ITAT) (ITA No. 4024 and 4027/Mum/2019, ITA No. 4185/Mum/2019)

The taxpayer had invested in two overseas subsidiaries in order to promote its business in the overseas market and boost its sales. However, due to consistent uncertain market conditions, the subsidiaries could not achieve the targets and accumulated heavy losses over a period of time which ultimately wiped off their respective net worth. Thus, both the overseas subsidiaries were under liquidation. Accordingly, the investments were written off and claimed as business loss by the taxpayer while computing business income.

The tax officer treated the foreign investments as capital investments and accordingly treated the receipt under the head capital gains, thereby disallowing the business loss.

The Mumbai ITAT observed that the investments were made to expand its business in the overseas market and to establish business connections in these markets. Thus, it was held that the investments had direct nexus with the taxpayer's business and any loss arising therefrom would be an allowable business deduction.

JMP Insights: *The allowability of write off of investments in subsidiaries has always been a debatable issue with numerous judicial precedents in favour and against it. The intention of the investment plays a prominent role in determining whether the loss from write off of the investment is a business loss or capital loss.*

- **Set-off of brought forward business loss of earlier years is allowed against income from capital gains**

  - Nandi Steels Limited (Karnataka High Court) (ITA No. 103 of 2017)

The taxpayer, in the given case had set off the business losses brought forward from earlier years against the income declared under the head 'Income from Capital gains' arising on the sale of land along with building, on the grounds that the land and building were used for its business activity.

The Hon'ble Karnataka HC observed that the heads described in section 14 of the Act are intended merely to indicate the class of income and they do not exhaustively delimit the sources from which the income arises. Since the asset being land along with building was being deployed by the taxpayer for its business activity, the nature of income derived from its sale is to be treated as directly linked with its business. Referring to the decision of Hon'ble Supreme Court in the case of ***GVK Industries Ltd (332 ITR 130)***, the HC relied on the fact that section 72(1)(i) of the Act states that a taxpayer can set off brought forward business losses against '*the profits and gains of any business or profession carried on by him' and does not use the words '**under the head** profits and gains of business or profession'.*

Accordingly, the Karnataka HC held that the taxpayer was entitled to set off brought forward business loss of earlier years against the income which has the character of business income even though the same was assessable to tax under a head other than the head 'Profits and gains of business or profession'.

JMP Insights: *While the taxpayer got relief in this case, what remains to be seen is whether income/profit from sale of land and building used for the taxpayer's business activities, **and not as trading assets**, can be said to be profits and gains of business or profession. In our view, this may be a difficult proposition and may lead to litigation.*

- **Question of beneficial treaty rate over DDT**

  - Total Oil India Pvt Ltd (Mumbai ITAT) (ITA No. 6997/Mum/2019)

Some of the shareholders of the taxpayer company are tax residents of France to whom dividend was paid by the taxpayer after deducting Dividend Distribution Tax ('DDT'). The issue under consideration was the applicability of beneficial DTAA rates for taxation of dividend over the rate of DDT under section 115-O of the Act.

The taxpayer relied on the ruling of the Delhi and Kolkata bench of the ITAT to further its argument that DDT has to be paid at a lower rate prescribed under the India-France DTAA.

The Mumbai ITAT however cast doubts on the correctness of these rulings. It observed that it is vital to the administration of justice that those exercising judicial power must have the necessary freedom to doubt the correctness of an earlier decision if and when subsequent proceedings bring to light what is perceived by them as an erroneous decision in the earlier case. In such circumstances, it is natural and reasonable to refer the case to a larger bench. Accordingly, the Mumbai Tribunal directed that the matter be placed before the Hon'ble President for his consideration to constitute a Special Bench with three or more members to address the issue.

- **Sum received from holding company for paying director's remuneration is a taxable receipt**

  - DCIT 4(2)(2) vs. M/s GBTL Ltd (Mumbai Tribunal) (ITA No. 2668/Mum/2018)

The taxpayer wanted to pay remuneration to its directors in excess of the limits specified in Schedule XIII to the Companies Act, 1956 ('the Companies Act'). The taxpayer therefore received a grant funds from its holding company to pay the remuneration beyond the maximum statutory limit under the Companies Act. The entire remuneration paid to the directors was claimed as a deduction in its return of income while treating the receipt from its holding company as a capital grant.

The taxpayer contented that the amount received from its holding company was a capital grant and was voluntarily paid to the taxpayer to enable it to comply with managerial remuneration provision as per schedule XIII of the Companies Act. Hence, it was not in the nature of a trading receipt. Further, the capital grant was not claimed as an expenditure in the hands of the holding company.

The Mumbai ITAT after considering all the facts denied the taxpayer's claim that the amount received from the holding company is a capital receipt. The ITAT held that the grant received from holding company could not be treated as exempt if the utilisation out of it was allowed as a deduction from the total income chargeable to tax.

JMP Insights: *This ruling brings out the principle that the tax treatment of the utilisation of the grant is important to determine the taxability of the grant received.*

Notifications and Circulars

- **CBDT introduces functionality to ascertain 'specified persons' for the applicability of higher rates of Tax Deducted at Source /Tax Collected at Source for non-filing of Return of Income (Circular No. 11 of 2021 dated 21 June 2021)**

With a view to ensure that the taxpayers who have borne reasonable amount of Tax Deducted at Source ('TDS') /Tax Collected at Source ('TCS'), file their Return Of Income ('ROI'), the Finance Act, 2021 introduced two new provisions in the Act – section 206AB and section 206CCA, which provide for higher tax deduction/collection in case the payment is to be made/received from a 'specified person'.

A taxpayer shall be treated as a 'specified person' if the following conditions are fulfilled:

- The time limit for filing the ROI has elapsed and the ROI is not filed for both of the two immediately preceding Financial Years ('FYs') relevant to the FY in which tax is required to be deducted or collected i.e. (FY 2018-19 and FY 2019-20 for FY 2021-22); and

- The aggregate of TDS and TCS exceeds INR 50,000 in each of these preceding two FYs.

However, recognizing the practical difficulties in implementation of section 206AB and 206CCA of the Act and to reduce the compliance burden on the tax deductors/collectors, the CBDT has issued a circular announcing a new functionality namely 'Compliance Check for Section 206AB and 206CCA' which is accessible on the reporting portal of the income tax website. The functionality enables a status check as to whether a deductee/collectee is a specified person for the purpose of Section 206AB/206CCA of the Act. A search can be conducted on the functionality with the help of the Permanent Account Number ('PAN') of the deductee/collectee, either in the form of a single search or a bulk PAN search (in case of large number of deductees/collectees).

For obtaining the information on the 'specified person', the tax deductor/collector will be required to separately register itself on the income tax e-filing portal. The portal will be updated each year based on the ROI filed by the taxpayers and it will be updated during the year, for deletions in the name of the specified persons, once the ROI is filed. The tax deductor/collector can download the details at the start of the FY and comply with the TDS/TCS liability based on the report generated/downloaded.

JMP Insights: *This is a welcome move by the Tax Department as this functionality will help the tax deductors/collectors to conduct proper due diligence and with ease so that they do not contravene the provisions of section 206AB and/or section 206CCA of the Act.*

With the functionality now in place, the tax deductor/collector will not be required to obtain any declaration from the taxpayer.

Please note that section 206AB and 206CCA of the Act is not applicable to a non-resident taxpayer who does not have a PE in India. Hence, in such cases the tax deductor/collector may still need to obtain a declaration from the non-resident that there is no change in its residential status and that it does not create a PE in India.

- **Extension in due-dates and tax exemption for compensation (CBDT Circular No. 12/2021 and Press Release dated 25 June 2021)**

In view of ongoing pandemic, the Tax Department has once again extended the due dates of certain compliances to provide relief to taxpayers. CBDT has also announced tax exemption for expenditure on Covid treatment and ex-gratia received on death due to Covid.

Various extended due dates are summarized below:

Sr. No	Nature of Compliance	Original Due date	New Due dates
1	Taxpayer required to file **objections to Dispute Resolution Panel ('DRP')** and Tax officer as per section 144C of Act	01.06.2021 or thereafter	Due date as per section or 31.08.2021, whichever is later
2	Statement of Tax Deduction at Source ('**TDS Return**') for the quarter ending 31 March 2021	31.05.2021	15.07.2021
3	Issuance of **TDS certificates** in Form 16 required to be furnished by employer for the FY 2020- 21	15.06.2021	31.07.2021
4	Statement of Income paid or credited by an investment fund to its unit holder in **Form No. 64D** for FY 2020-21	15.06.2021	15.07.2021
5	Statement of Income paid or credited by an investment fund to its unit holder in **Form No. 64C** for FY 2020-21	30.06.2021	31.07.2021
6	Taxpayer required to file application via **Form No. 10A/10AB** for registration/ provisional registration/ intimation/ approval of trust/ institutions etc.	30.06.2021	31.08.2021
7	Taxpayers required to make **investments** for claiming exemptions under **section 54 to 54GB** of the Act	Between 01.04.2021 to 29.09.2021 (Both inclusive)	30.09.2021
8	Furnishing quarterly statement in **Form No 15CC** in respect of remittance made for quarter ending 30.06.2021	15.07.2021	31.07.2021
9	Equalization levy statement in **Form No.1** for FY 2020-21	30.06.2021	31.07.2021
10	Annual Statement by eligible investment fund in **Form No. 3CEK**	29.06.2021	31.07.2021
11	Submitting declaration in **Form No. 15G/15H** during quarter ending 30.06.2021	15.07.2021	31.08.2021
12	Exercising option under section 245M(1) of the Act in **Form No 34BB**	27.06.2021	31.07.2021
13	Linking Aadhar with PAN	30.06.2021	30.09.2021
14	Payment of amount under Vivad se Vishwas (without additional amount)	30.06.2021	31.08.2021
15	Payment of amount under Vivad se Vishwas (with additional amount)		31.10.2021
16.	Time limit for passing assessment order	30.06.2021	30.09.2021
17	Time limit for passing penalty order	30.06.2021	30.09.2021
18.	Time limit for processing Equalisation Levy Returns	30.06.2021	30.09.2021

DID YOU KNOW?

Newly introduced section 194Q of the Act, being TDS on payment of certain sums for purchase of goods, is applicable from 1 July 2021. On 30 June 2021, the CBDT has issued guidelines, to address the various queries raised.

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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