# Tax Matters

Issue No. 2022/01 Date: 10 January 2022

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 2021:

## *Income tax rulings*

- **Fees for "use" of a full-fledged Information Technology ('IT') infrastructure facility taxable as industrial royalty**

  - Bekaert Industries Private Limited (Pune Tribunal) [ITA No.1003/PUN/2017]

  The Pune Tribunal has held that where payment is made for use of a full-fledged IT infrastructure facility, consisting of ERP system (SAP), SAP platforms, hardware, software, servers, network, domain structures and security, it tantamounts to payment for the use of an "industrial equipment" and hence constitutes royalty, in view of clause (iva) of Explanation 2 to Section 9(1)(vi) of the Income-tax Act, 1961 ('the Act').

  The Pune Tribunal distinguished the facts of the instant case from the ruling of the Hon'ble Supreme Court ('SC') in the case of Engineering Analysis Centre of Excellence Pvt. Ltd. v. CIT (2021) 432 ITR 472 (SC). The Tribunal held that the ruling of SC is applicable in cases involving 'copyright royalty' and not 'industrial royalty' which consists of payment for "use" of industrial equipment. The Tribunal also held that the facts in the instant case are akin to the facts considered in the decision of the coordinate bench in the case of Rieter Machine Works Ltd v. ACIT (ITA No. 19/PUN/2021) wherein, it was held that such payments constitute royalty.

  It was further held that as per section 254(1) of the Act read with rule 11 of the Income-tax Appellate Tribunal Rules,1963, the Tribunal has sweeping powers of passing any order as it thinks fit, but the essential condition is that some material – factual or legal – must exist to support the view sought to be canvassed by it on the subject matter, which is different from that of the tax officer.

  ***JMP Insights*** *–This decision distinguishes copyright royalty from industrial royalty. Though the SC has ruled that payment for the right to use a copyrighted software will not constitute royalty, due attention needs to be paid to the fact whether the copyrighted material forms part of a larger IT infrastructure, payment for the use of which constitutes industrial royalty.*

- **Taxpayer not liable for malfunctioning of e-appeal facility physically filed appeal held to be valid**

  - Estate of Ramniklal Rajmal Mehta (Mumbai Tribunal) [ITA Nos. 628 to 632/Mum/2021]

The taxpayer had filed an appeal before the Commissioner of Income-tax (Appeals) ['CIT(A)'] in physical mode, being unable to file it in online mode due to technical glitches. Later, the taxpayer also filed the appeal in electronic mode. The CIT(A) dismissed the appeal on the ground that the appeal needs to be filed only in the prescribed mode as per Rule 45 of the Income-tax Rules,1962 ('the Rules'), which is through the e-Appeal facility.

The Mumbai Tribunal ruled that the Rules have been framed to achieve the ends of justice and not to put impediments in the path of justice. The Tax Department cannot take the benefit of malfunctioning of the e-Appeal facility on the income tax portal to deny the statutory right of appeal to the taxpayer. The CIT(A) was directed to decide the appeal filed physically as well as electronically on merits, and to grant the taxpayer an opportunity of being heard as well as to file documents as may be necessary.

***JMP Insights*** *–Due to frequent non-functioning/malfunctioning of the income tax portal this year, the taxpayers have faced several hurdles in getting their compliances completed. In view of this, it is suggested that the taxpayer should keep a record of such attempts made to comply and raise a grievance with the Tax Department so that in the event the non-compliance/late compliance is challenged in the future, it can be proved that sincere efforts were made by the taxpayer in complying with the law.*

- **Just because submissions were made on merits, that would not empower the Tribunal to recall its own order under section 254(2) of the Act**

  - Reliance Telecom Limited and Reliance Communications Ltd (SC)] [Civil Appeal No. 7110 & 7111 of 2021]

The Mumbai Tribunal had passed a detailed order in favour of the Tax Department, in an appeal by the Tax Department against the order of the CIT(A). Aggrieved by the order of the Mumbai Tribunal, the taxpayer filed a Miscellaneous Application before the Mumbai Tribunal, under Section 254(2) of the Act, for rectification of mistake apparent from record. Additionally, the taxpayer also filed an appeal before the Bombay High Court ('HC') against the order of the Tribunal. The Tribunal allowed the Miscellaneous Application filed by the taxpayer and recalled its original order. Consequently, the taxpayer withdrew the appeal filed before the HC against the original order of the Tribunal.

Aggrieved by this, the Tax Department preferred a writ petition before the HC against the common order of the Tribunal allowing Miscellaneous Application of the taxpayer and recalling its original order. The writ petition was dismissed by the HC on the ground that the Tax Department had filed submissions on merits of the case and did not challenge the powers of the Tribunal to admit the Miscellaneous Application. Aggrieved, the Tax Department preferred an appeal before the SC.

The SC held that, under Section 254(2) of the Act, the Tribunal is only empowered to rectify any mistake apparent from record. In the present case, the Tribunal has revisited the earlier order and gone into detail on merits of the case. It was held that this is beyond the powers of the Tribunal under Section 254(2) of the Act. Consequently, the common order of the Tribunal recalling its original order as well as the order of the HC dismissing the writ petition of the Tax Department were quashed by the SC and the original order of the Tribunal was restored.

***JMP Insights*** *–The Tribunal does not have the power to re-hear an entire appeal on merits. It does not acquire this power even if the Tax Department and/or the taxpayer goes in detail into the merits and/or files detailed submissions.*

- **Revisionary jurisdiction unfettered during the pendency of appeal before CIT(A), doctrine of merger not triggered**

  - JR Industries/OM Industries/Vikas Oil Product (Jaipur Tribunal) [ITA No. 26/JP/2021, ITA No. 27/JP/2021 & ITA No. 28/JP/2021]

The tax officer disallowed bogus sales based on the information received from the investigation wing. The taxpayer had filed an appeal before the CIT(A) against the assessment order. While the appeal was pending disposal, the Commissioner of Income Tax ('CIT') had invoked revisionary proceedings under section 263 of the Act against the assessment order passed by the tax officer and passed an order. The order passed by the CIT was challenged by the taxpayer before the Jaipur Tribunal.

It was observed that the power under section 263 of the Act extends to such matters which had not been considered and decided in any appeal. The words 'considered and decided' imply that if an issue is decided by the CIT(A), then that issue cannot be a subject matter of proceedings under section 263 of the Act by the CIT. Reference was made to the doctrine of merger wherein the assessment order would be said to be merged only when the issue was decided by the higher authority. In other words, till the matter is pending before the CIT(A), the assessment order could be subject matter of revision by the CIT as there is no order of a higher authority that the assessment order could merge with.

It was also observed that the proceedings under section 263 of the Act are time bound as against in case of appeal before the CIT(A), wherein there is no time limit for the CIT(A) to adjudicate the appeal. Section 263 of the Act will be practically redundant if the CIT cannot exercise his powers under section 263 of the Act until the appeal is disposed of by the CIT(A).

The Jaipur Tribunal distinguished the decisions relied upon by the taxpayer as they pertained to section 33A of the old Income-tax Act, 1922. Section 33A of the old Income-tax Act, 1922 contained a proviso that the CIT cannot invoke revisionary proceedings if an appeal is filed pending adjudication. This proviso is not present in section 263. It clearly reflects the legislative intent that even during the pendency of the appeal before CIT(A), the CIT can assume jurisdiction under section 263 of the Act.

The Jaipur Tribunal accordingly concluded that the CIT was correct in invoking the revisionary proceedings under section 263 of the Act.

***JMP Insights*** *–In forming a view or defending a case, support can be taken from the court decisions passed under the old Income-tax Act, 1922. However, in doing so, care should be taken that the language used in the old Income-tax Act, 1922, on the basis of which such court rulings were made, corresponds materially to the Income-tax Act, 1961.*

- **Education cess is an additional surcharge, not an allowable expenditure**

  - Kanoria Chemicals & Industries Ltd (Kolkata Tribunal) [ITA No. 2184/Kol/2018] and [ITA No. 2439/Kol/2018]

The taxpayer raised an additional ground of appeal before the Kolkata Tribunal that the tax officer ought to have allowed deduction of education cess in computing the taxable business income.

Under the Act, any 'rate or tax' levied on profits and gains from business or profession is not allowed as a deduction. It was argued by the counsel of the taxpayer that section 40(a)(ii) of the Act does not cover the words 'cess' and relied on the Circular No. 91/58/66-ITJ (19) dated 18 May 1967 of the Central Board of Direct Taxes ('CBDT') to state that at the time of introducing the Income Tax Bill, 1961, it was proposed to disallow cess. However, later on when the Income tax Bill, 1961 was passed by the Legislature, disallowing the cess as an expenditure was dropped as per the recommendation of the Select Committee constituted by the Legislature.

It was also held by the Bombay HC in the case of Sesa Goa Limited [(2020)117 taxmann.com 96] and by the Rajasthan HC in the case of Chambal Fertilizers & Chemicals Ltd [D.B. Income-tax Appeal No. 52/2018], that cess as an expenditure is not disallowable under section 40(a)(ii) of the Act.

The Kolkata Tribunal however observed that this issue is covered by the decision of the SC in the case of CIT v. K. Srinivasan (1972) 83 ITR 346 wherein the SC held that 'surcharge' as per Webster's New International Dictionary means additional tax. Surcharge and additional surcharge are part of income tax. Education cess was introduced in the year 2004 as an additional surcharge.

In view of the above, Kolkata Tribunal held that education cess is not an allowable deduction.

***JMP Insights*** *–The issue of whether education cess is allowable as a tax-deductible expenditure has been a litigious issue where there are decisions in favour as well as against the taxpayer. It is therefore suggested that before forming a view of considering education cess as deductible, a detailed analysis is done and documented as a defence in case of any litigation.*

## *Notifications*

- **CBDT prescribes conditions to claim exemption from income received/accrued by non-resident from transfer of non-deliverable forward contracts.**

  As per section 10(4E) of the Act, any income accrued/received by a non-resident from transfer of non-deliverable forward contracts to an offshore banking unit of an International Financial Services Centre ('IFSC') shall be exempt from income tax subject to fulfilment of prescribed conditions.

  CBDT vide Notification No.136/2021/F.No.370142/53/2021-TPL (Part-II) dated 10 December 2021 has prescribed the conditions by insertion of a new Rule 21AK in the Rules.

  The conditions to be complied are as follows: -

  1. The non-deliverable forward contract is entered into by the non-resident with an offshore banking unit of an IFSC which holds a valid certificate of registration granted by the International Financial Services Centres Authority.

  2. Such contract is not entered into by the non-resident through or on behalf of its Permanent Establishment ('PE') in India. The offshore banking unit will have to ensure that this condition on PE is complied with.

**DID YOU KNOW?**

*Recently, the CBDT has notified the Faceless Appeal Scheme, 2021 ('Scheme 2021'), with effect from 28 December 2021. This is in supersession of the Faceless Appeal Scheme, 2020. One of the important changes made in the Scheme 2021 is that personal hearing through video-conferencing will no longer be discretionary and shall be granted by the CIT(A) upon request.*

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

**About JMP Advisors**

JMP Advisors is a leading professional services firm that offers advisory, tax and regulatory services. The vision of JMP Advisors is to be 'The Most Admired Professional Services Firm in India'. It aims to be the best as measured by the quality of its people and service to clients. The firm has a merit-based culture and operates to the highest standards of professionalism, ethics, and integrity. Jairaj (Jai) Purandare, the Founder Chairman has over three and half decades of experience in tax and business advisory matters and is an authority on tax and regulation in India. Jai was Regional Managing Partner, Chairman-Tax and Country Leader-Markets & Industries of PricewaterhouseCoopers India. Earlier, Jai was Chairman of Ernst & Young India and Country Head of the Tax & Business Advisory practice of Andersen India.

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 and policy foresight 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.

JMP Advisors has been recognized as a leading Tax firm in India in the International Tax Review (Euromoney) World Tax Directory for all successive years since incorporation, including in the World Tax and Transfer Pricing 2022 Directory.

**Disclaimer**

This material and the information contained herein is of a general nature and is not intended to address specific issues of any person. Any person acting on the basis of this material or information shall do so solely at his own risk. JMP Advisors Private Limited shall not be liable for any loss whatsoever sustained by any person who relies on this material or information.