Tax Matters

Issue No. 2022/03 Date:1 March 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 months of January and February 2022:

Income tax rulings

- **No deduction allowed for expenditure incurred towards 'freebies' given by Pharma Companies to Doctors**

  - Apex Laboratories Pvt Ltd. [TS-104-SC-2022]

The Honourable Supreme Court ('SC') dismissed the taxpayers appeal and held that freebies (such as hospitality, conference fees, gold coins, LCD Televisions, fridges, laptops, etc.) gifted by the taxpayer to medical practitioners was against the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 ('MCI Regulations') and therefore 'prohibited by law' as per Explanation 1 to section 37(1) of the Income-tax Act, 1961 ('the IT Act'). Accordingly, a deduction for expenditure incurred on freebies would not be allowed under section 37(1) of the IT Act. The SC's reasons are elaborated as under:

- Drawing reference from various statutes, the terms '*offence'* or '*prohibited by law'*, as used under section 37 of the IT Act, contain within their ambit all such activities that are illegal, prohibited by law and punishable.
- Acceptance of freebies given by pharmaceutical companies is an offence on the part of the medical practitioners, punishable with varying consequences as per the MCI Regulations.
- It is against public policy to allow the benefit of deduction under one statute for any expenditure incurred in violation of the provisions of another statute or any penalty imposed under another statute.
- The view that the MCI Regulations are inapplicable to pharmaceutical companies, and hence there is no violation of any law, defeats the purpose for which Explanation 1 was inserted into section 37 of the IT Act.
- The incentives which the taxpayer has given to the doctors had the direct result of exposing the recipients to sanctions or bans on their practice. These sanctions are mandated by law and have a legally binding effect. Prohibition on medical practitioners' acceptance of such incentives is no less a prohibition on the giver, i.e. the taxpayer. Hence, gifting of freebies by the taxpayer to doctors is clearly 'prohibited by law' and not allowed to be claimed as a deduction under section 37 of the IT Act.

JMP Insights- *This SC decision settles the controversy over deductibility of expenditure incurred on 'freebies' given to Doctors, in favour of the Tax department. In a way, this*

decision gives endorsement to the amendment proposed in Finance Bill 2022, wherein Explanation 3 to section 37(1) of the IT Act is proposed to be inserted insofar as the disallowance applies to an expense incurred to provide any benefit or perquisite to a person if acceptance of such benefit or perquisite is in violation of any law.

- **Separate notification not required for availing benefit of Most Favoured Nation ('MFN') clause under India-Spain Double Taxation Avoidance Agreement ('DTAA')**

  - GRI Renewable Industries S.L (Pune Tribunal) [ITA No.202/PUN/2021]

The Pune Tribunal has held that the MFN clause contained in the protocol to India-Spain DTAA was signed on the same date on which such DTAA was signed. On notification of India-Spain DTAA, the protocol containing MFN clause triggering the import of any other DTAA (India-Portugal DTAA in the instant case) fulfilling the requisite requirements, gets automatically notified in terms of section 90(1) of the IT Act. Therefore, benefit of lower rate of tax of 10% under India-Portugal DTAA can be availed by the taxpayer under India-Spain DTAA read with protocol to such DTAA.

By referring to the opening lines of the protocol to the India- Spain DTAA, the Pune Tribunal held that protocol is treated as an integral part of the DTAA and would get automatically notified along with the DTAA and accordingly, there is no need to again notify the individual limbs of the DTAA (being protocol in this case).

The Central Board of Direct Taxes ('CBDT') via circular no.3/2022 dated 3 February 2022, has mandated the issuance of separate notification for importing the benefits via MFN clause. In this regard, the Pune Tribunal has observed that the circular specifying the need for a separate notification for importing the beneficial treatment from another DTAA as a corollary of Section 90(1) overlooks the plain language of the provision in juxtaposition to the language of the protocol, which treats the MFN clause an integral part of the DTAA.

The Tribunal further held that it is trite law that CBDT circular is binding on Tax Officer and not the taxpayer or Tribunal or any other appellate authorities, and the circular transgressing the boundaries of section 90(1) of the IT Act cannot be binding on Tribunal.

While placing reliance on plethora of judicial precedents, it was further held that a piece of legislation which imposes new obligation or attach a new disability is considered as prospective unless the intent is clearly stated to give it a retrospective effect. Accordingly, it was held that CBDT circular cannot operate retrospectively to transactions taking place in any period before its issuance.

JMP Insights *–This is the first ruling after the issuance of CBDT circular and has provided detailed reasoning on non-applicability of condition of separate notification of MFN clause and for treating Protocol as an integral part of the DTAA. This ruling may also be relied on by the taxpayers while availing benefit of MFN clause under any other DTAA containing MFN clause in the Protocol, which has same language as the Protocol to the India-Spain DTAA.*

- **Taxpayers can file condonation application for delay in electronic filing of Form 10IC for availing concessional corporate tax rate**

  - Rajkamal Healds and Reeds Pvt. Limited (Gujarat High Court) [R/Special Civil Application No. 1085 of 2022]

The taxpayer filed the return of income claiming the lower rate of corporate tax at 22% but failed to file Form no.10-IC electronically, which is mandatory required to be filed on or before the filing of tax return for exercising the option of availing concessional corporate tax rate.

The Gujarat High Court held that the taxpayer should at the earliest file an appropriate application in writing addressed to the Principal Chief Commissioner/ Chief Commissioner of Income-tax making a request to permit the taxpayer to file the Form no.10-IC electronically after condoning the delay. The Gujarat High Court directed the Chief Commissioner/ Commissioner of Income-tax to process the application expeditiously once it is filed by the taxpayer and exercise discretionary powers considering the object behind section 119(2)(b) of the IT Act and genuine hardships to taxpayer.

JMP Insights *– The taxpayers with similar fact pattern who have either filed an application before the Principal Chief Commissioner/ Chief Commissioner of Income-tax for condonation of delay and acceptance of Form no. 10-IC belatedly can rely on this ruling to expedite the processing of application.*

- **Withholding tax on payment for cloud services restricted to 8% as interim measure on account of 2% Equalisation Levy ('EL')**

  - Google Asia Pacific Pte Limited (Delhi High Court) [W.P.(C) 215/2022]

A writ petition was filed by the taxpayer against the tax withholding certificate issued by the Tax Officer directing Google Cloud India Pvt Ltd. ('GCI') to withhold tax at the rate of 10% at the time of making payment to the taxpayer for cloud services.

The taxpayer contented that it had already been subjected to EL of 2% on the payments under consideration and withholding tax certificate issued by the Tax Officer creates a double jeopardy. Considering the contention of the taxpayer, the Delhi High Court purely as an interim measure directed that the taxpayer would be entitled to receive payment from GCI after tax withholding at the rate of 8%.

JMP Insights *– The Finance Act, 2021 clarified that EL shall not apply if the payment is taxable as Royalty / Fees for Technical Services ('FTS') under the Act read with DTAA. The taxpayer should bear this in mind while determining their tax withholding requirements.*

- **Provision of marketing research and sales support services through technical personnel for Indian company's business outside India are not taxable as FTS**

  - Orkla Asia Pacific Pte Limited (Bangalore Tribunal) [ITA No. 193/Bang/2019]

The Bangalore Tribunal in this case has observed that the service agreement is between the Indian Company, MTR Foods (MTR Foods) Pvt. Ltd. and the taxpayer (Orkla Asia Pacific Pte Limited) and not with the employee of the taxpayer individually. Therefore, this cannot be considered as secondment of employee.

The Tribunal further observed that as per the service agreement, marketing research and sales support services were provided by an employee of the taxpayer outside India and utilised by MTR Foods for its business carried on outside India. Therefore, the Bangalore Tribunal has held that the services rendered by the taxpayer are not deemed to accrue or arise to the taxpayer in India and not taxable as FTS under section 9(1)(vii)(b) of the IT Act.

Reliance was placed on the Delhi Tribunal decisions of Lufthansa Cargo India Pvt. Limited (91 ITD 133) and Titan Industries Limited (11 SOT 206), wherein it was held that as the source of earning income was outside India, the amount paid will be covered in exception provided under section 9(1)(vii)(b) of the Act. Further, the Honourable SC in case of GVK Industries Limited (371 ITR 453) while dealing with the above exception observed that such exception applies to a situation when fee is payable in respect of services utilised for business or profession carried out by an resident payer outside India or for the purpose of making or earning of income from any source outside India.

The Bangalore Tribunal relying on the various decisions dealing with the term 'make available' pertaining to FTS under the DTAA held that the services rendered by the taxpayer have not made available technical knowledge, skills, etc., to MTR Foods and therefore, not taxable under the India-Singapore DTAA.

Circular

➢ CBDT specifies conditions for availing the benefit of MFN clause in DTAA

The protocol to India's DTAAs with some European Countries (e.g. The Netherlands, France, Switzerland, Spain, etc.) contains MFN clause.

Typically, by way of MFN clause, India limits its source taxation rights of certain incomes (such as dividend, royalty, FTS, etc.), if after signature/entry into force of the DTAA with first State (original DTAA), India enters into a DTAA subsequently with a third country ('second DTAA') which is a member of Organisation for Economic Co-operation and Development (OECD), providing a beneficial rate of tax or restrictive scope for taxation of such streams of income.

CBDT vide circular no. 3/2022 dated 3 February 2022 has specified following conditions to be satisfied cumulatively for applicability of MFN clause present in the Protocol to India's DTAAs with various Countries:

1. The second DTAA is entered into after the signature/ entry into force (depending on language of the MFN clause) of the original DTAA.
2. As on the date of signing of the second DTAA, the third country is a member of OECD.
3. India has restricted the scope of taxation or agreed on a lower rate of withholding tax for the relevant source of income in the second DTAA, and
4. A separate notification has been issued by India, importing benefits of second DTAA in original DTAA

CBDT has clarified in the circular that unilateral decree/ bulletin issued by treaty partners (The Netherlands, France and Switzerland) does not represent mutual understanding of India and the treaty partners and has been issued without bilateral consultation with India and hence doesn't have binding effect as far as the interpretation of MFN clause is concerned in those DTAAs.

It is also clarified that the benefit of concessional rate/restricted scope will be available from the date of entry into force of the DTAA with the third State and not from the date on which such third State becomes an OECD member.

The Circular has provided for an exception where in case of a taxpayer there is any decision by any court on this issue favourable to such taxpayer, this Circular will not affect the implementation of the court order in such case.

JMP Insights *– The said circular clarifies India's official position on non-applicability of 5% tax rate for dividend income from treaties with Slovenia, Lithuania and Columbia into certain other treaties via MFN clause, which is against the Ruling of Delhi HC in case of Concentrix services Netherlands B.V v. ITO (2021) 434 ITR 516. The Circular also deviates from the position approved by Delhi HC in case of Steria India (2016) 386 ITR 390 by providing that the benefit of the MFN clause shall not be allowed in the absence of a separate notification of protocol containing MFN clause of the DTAA by the Indian Government. The taxpayers intending to*

take the benefit of MFN clause need to evaluate the impact of circular taking into account applicable legal position and risks and consequences associated with short or non-deduction of withholding tax. The taxpayer may also rely on the decision of the Pune Tribunal in the case of GRI Renewable Industries S.L (supra).

DID YOU KNOW?

The Ministry of Corporate Affairs vide notification no. F.No. 01/03/2021-CLV-Part I dated 11 February 2022 has appointed 1 April 2022 as the date from which the provisions of Sections 1 to 29 of the LLP Amendment Act 2021 shall come into force. The LLP Amendment Act, 2021 is introduced to facilitate greater ease to law abiding corporates and to decriminalise certain provisions of the LLP Act.

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.