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 and overseas direct investment regime during August 2022:

Income tax rulings

➢ **The High Court ('HC') upholds the independence of the tax officer's right to reassess the income of the taxpayer during the pendency of an appeal against an assessment order**

- Sunil Jain v. Income Tax Department through National Faceless Assessment Centre, Delhi and Anr. (Delhi HC)[1]

The taxpayer's income was enhanced by the tax officer during limited scrutiny, for unexplained cash deposits in the bank account held with Corporation Bank. Aggrieved, the taxpayer appealed to the CIT(A). While the appeal was pending, the tax officer reopened the assessment for the same year under section 148 with regard to cash deposited in a bank account held with Punjab National Bank and made a further addition to total income.

The taxpayer filed a writ petition with the Delhi HC against the reassessment order, on the ground that while the appeal is pending, the tax officer cannot issue notice for reassessment, as it is a mere change of opinion and encroaches upon the exclusive jurisdiction of the CIT(A) of enhancing the assessment in an appeal before him.

The HC observed as follows:

- The reassessment notice and consequential reassessment order pertain to the alleged cash deposits in the bank account with Punjab National Bank which was not adjudicated during the assessment proceedings. The HC distinguished the ruling of Bombay HC in the case of *Ardor Technopark Ltd. v. Dr. Zakir Hussein, DCIT*[2], where simultaneous proceedings for revision of assessment undertaken by the CIT and reopening of assessment by the tax officer on the same issue were held to be invalid. However, the HC observed that in the present case, the transaction under consideration before the CIT(A) was a different transaction than the one considered in the reassessment.
- Prima facie, the contention of the taxpayer with regard to complete disclosure of cash deposits in all bank accounts in return of income is incorrect as the taxpayer had not mentioned the details of cash deposited with Punjab National Bank.

[1] [W.P. (C) 6036/2022 & CM APPLs. 18121-18122/2022]
[2] (2004) 271 ITR 50 (Bom)

- The HC relied on the Full Bench ruling of Delhi HC in the case of *CIT vs. Usha International Ltd*[3], wherein it was held that when at the first instance in the original assessment proceedings no opinion is formed, the principle of change of opinion does not apply.

Accordingly, the HC dismissed the writ petition filed by the taxpayer.

***JMP Insights** – The HC placed emphasis on the fact that the transactions under appeal and reassessment were two distinct transactions and hence both the proceedings could be conducted simultaneously.*

- **Taxpayer eligible to claim depreciation on the non-compete fee paid on acquiring business**

  - Abbott Healthcare Private Limited v. Asstt. Commissioner of Income Tax, Circle 2(1)(1), Mumbai (Mumbai Tribunal)[4]

The taxpayer claimed depreciation on the non-compete fee paid by categorising it as an intangible asset. The tax officer disallowed the taxpayer's claim of depreciation on the non-compete fee of INR 1283.8 mn.

The taxpayer appealed before the CIT(A). Without prejudice to the primary contention, the taxpayer also raised an alternate ground before the CIT(A) that the non-compete fee be treated as deferred revenue expenditure and should be allowed to be amortised over a period of eight years. The CIT(A) accepted the taxpayer's alternate plea and directed the tax officer to treat the non-compete fee as deferred revenue expenditure for a period of eight years.

The taxpayer filed an appeal before the Tribunal on certain other grounds decided against it by the CIT(A). Subsequently, relying on the decision of the Bombay HC in the case of *Piramal Glass Limited*[5], the taxpayer filed additional grounds of appeal claiming that depreciation on non-compete fee should be allowed to the taxpayer under section 32 of the Act. The Tax department also filed a cross-appeal.

The Mumbai Tribunal concurred with the view of the CIT(A) to consider the non-compete fee as deferred revenue expenditure. However, taxpayer's additional ground on the allowability of depreciation on non-compete fee remained unadjudicated.

The taxpayer filed a Miscellaneous Application ('MA') for rectification of the Tribunal's order. The Mumbai Tribunal recalled its earlier order only to the extent of adjudicating on the additional ground raised by the taxpayer.

The taxpayer is thus in the second round of appeal before the Tribunal.

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[3] [2012] 348 ITR 485 (Delhi)
[4] (ITA No. 570/MUM/2018)
[5] (80 taxmann.com 68)

The Mumbai Tribunal noted that relying on the decision given by Gujarat HC in the case of *Principal Commissioner of Income Tax v. Ferromatice Milacron India (P.) Limited*[6]*, the* Bombay HC in the case of *Pr. CIT – 7 v. Piramal Glass Limited (supra)*, has held that the non-compete fee is eligible to depreciation.

The HC observed that CIT(A) had passed the order on 08/11/2017. The CIT(A) did not have the benefit of the decision rendered by Bombay HC in the case of *Piramal Glass Ltd.(supra)* as the said decision was delivered after the CIT(A) disposed off the appeal. The said decision of Bombay HC was not brought to the notice of Mumbai Tribunal in the first round and was brought to the Tribunal's notice for the first time in MA proceedings.

The Mumbai Tribunal thus held that the taxpayer is eligible for depreciation under Section 32 as non-compete fee is an intangible asset.

JMP Insights *– Apart from the Bombay HC decision in case of Piramal Glass (supra) which in turn relied on the Gujarat HC decision in the case of Ferromatice Milacron (supra), even Karnataka HC and Madras HC have held that expenditure incurred for acquiring non-compete right is capital in nature and entitled to depreciation as an intangible asset.*

However, Delhi Tribunal in case of Sagar Ratna Restaurants (P.) Ltd. v. Assistant Commissioner of Income-tax[7] *has held that the advantage arising from non-compete fees was restricted only against the seller and it is not similar to intangible assets with business or commercial rights which could be transferred or traded and thus non-compete fee paid by the taxpayer would not be an intangible asset within the ambit of section 32 and depreciation claim was not allowed to the taxpayer.*

On the issue of depreciation on non-compete fees, there are contrary views of various HCs. The taxpayer should take into consideration the view of the jurisdictional HC/Tribunal ruling as well as the facts of its case before making a claim.

- **Amalgamated company/taxpayer cannot claim set off of those losses which are not allowed to be set off to the amalgamating company/closely held company**

    - Asst. Commissioner of Income Tax, Range 8(2) v. M/s Hotel Leela Venture Ltd. (Mumbai Tribunal)[8]

The taxpayer acquired majority shareholding (more than 51%) in a closely held company (Say, Company A) during the Financial Year ('FY') 2005-06. The provisions of section 79 of the Act do not allow a closely held company to set off the brought forward loss if there is a change in shareholding to the extent of not less than 51% from the year in which the losses were incurred to the year in which the losses are set off. Therefore, the loss was

[6] [(2018) 99 taxmann.com 154 (Gujarat)]
[7] [(2022) 139 taxmann.com 87]
[8] (ITA No. 4453/MUM/2013)

denied to Company A by the tax officer. Company A had appealed against the order of the tax officer however, the decision was pending.
During FY 2006-07, the Company A (i.e. the amalgamating company) was amalgamated with the taxpayer (i.e. amalgamated company). The taxpayer claimed set off of the losses of the amalgamating company which was denied by the tax officer. The taxpayer contended that the provisions of section 72A of the Act which deals with carry forward and set off of losses in case of amalgamation are applicable being more specific than the general provisions of section 79 of the Act.

The Mumbai Tribunal held that once the tax officer in the case of Company A for the FY 2005-06 has already rejected the claim of carry forward of the business loss in terms of section 79 of the Act, then same cannot be available to the taxpayer for set off under section 72A of the Act until and unless said finding of the tax officer is reversed by the higher appellate authorities. Since Company A (now amalgamated with the taxpayer) had filed an appeal against the order of the tax officer denying the carry forward of losses, the said business loss became eligible to the taxpayer for set-off only subsequent to the decision of the Appellate Authorities.

Notifications

➢ Reduction in time limit to verify the return of income

The income tax return ('ITR') filed on or before 31 July 2022 required e-verification or sending the ITR acknowledgment to be sent to Centralised Processing Centre ('CPC'), Bangalore, within 120 days from the date of filing of the ITR.

The CBDT vide Notification No. 5 of 2022 dated 29 July 2022 has reduced the aforesaid time limit from 120 days to 30 days, in respect of the Income tax returns filed on or after 1 August 2022.

If the ITR is e-verified or the ITR acknowledgement is sent to CPC after 30 days, then the date when such return is e-verified or the ITR acknowledgement is submitted shall be treated as the date of filing the return of income and the taxpayer will be subject to the consequences of late filing of return under the Act.

This Notification has come into effect from 1 August 2022.

➢ No tax would be collected at source from a non-resident buyer not having a Permanent Establishment in India

Section 206C(1G) of the Act requires the Authorised Dealer/Seller to collect tax at the time of receipt/debit in the account from the buyer in the following situations:-

- Amount received by the Authorised Dealer for making remittances outside India under the Liberalised Remittance Scheme ('LRS') of the Reserve Bank of India exceeds INR 7 Lac

- Amount received by the Seller of an overseas tour package for booking an overseas tour package.

The Central Board of Direct Taxes ('CBDT') vide Notification No. 99/2022 dated 17 August 2022 has notified that where the buyer is a non-resident in India and does not have a Permanent Establishment in India, no tax will be collectable by the Authorised Dealer/Seller.

- **CBDT notifies Form 29D for claiming refund of tax deducted and borne in certain situations**

A new Section 239A was inserted in the Act, vide the Finance Act, 2022, whereby the deductor (i.e. the payer of income) can claim a refund of the tax deducted and paid, in cases where actually no tax was required to be deducted on payment to a non-resident, and such withholding tax was borne by the deductor.

The CBDT, vide Notification No. 98/2022 dated 17 August 2022, has notified Form 29D in which the application is required to be made by the deductor for claiming such refund. Form 29D is required to be accompanied by a copy of an agreement, basis which the deductor has formed an opinion that no tax was actually required to be deducted.

New Overseas Investment Regime

The Central Government and Reserve Bank of India has notified the following rules and regulations on 22 August 2022,

- Foreign Exchange Management (Overseas Investment) Rules, 2022 ('OI Rules');
- Foreign Exchange Management (Overseas Investment) Regulations, 2022 ('OI Regulations');
- Foreign Exchange Management (Overseas Investment) Directions, 2022 ('OI Directions')
- Master direction - Liberalised Remittance Scheme ('LRS')

The key highlights of changes emanating from the combined reading of the OI Rules, OI Regulations, OI Directions and LRS (collectively referred to as the 'New Overseas Investment Regime') are as follows:

- *Foreign entity* - The concept of Joint Venture and Wholly Owned Subsidiary is substituted by the concept of Foreign entity, which means an entity formed or registered or incorporated outside India, including the International Financial Services Centre ('IFSC') in India, that has limited liability.

- *Overseas Direct Investment ('ODI')*- Under the new regime, ODI means:
  a. acquisition of any unlisted equity capital or subscription as a part of the memorandum of association of a Foreign entity, or
  b. investment in 10% or more of the paid-up equity capital of a listed foreign entity, or

c. investment with control where investment is less than 10% of the paid-up equity capital of a listed foreign entity.

ODI is prohibited in a foreign entity engaged in

a. real estate activity
b. gambling in any form
c. dealing with financial products linked to the Indian rupee without specific approval of the RBI

   The total financial commitment by an Indian entity in all the foreign entities taken together at the time of undertaking such commitment shall not exceed 400 percent of the net worth as on the date of the last audited balance sheet.

- *Overseas Portfolio Investment ('OPI')* - OPI means any overseas investment which is not ODI, other than investment in any unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC.

  Indian entity may make OPI which shall not exceed fifty percent of its net worth as on the date of its last audited balance sheet.

- Overseas Investment ('OI') – OI means financial commitment and OPI by a person resident in India.

- *Investment in Financial Services sector* - Indian companies which are not in the financial services can now directly invest in Foreign entities engaged in financial-services activities (except banking or Insurance) such as brokerages, asset management funds, and credit cards under the automatic route subject to certain conditions . Earlier, such investment was prohibited.

- *Round Tripping* - New Overseas Investment regime specifically prohibits any financial commitment by a person resident in India in a foreign entity that has, directly or indirectly, invested or invests into India at the time of making such financial commitment or at any time thereafter, resulting in a structure with more than 2 layers of subsidiaries. This implies that, though not explicitly mentioned, structures involving upto 2 levels of subsidiaries will not require prior RBI approval.

- Issuing corporate guarantees to or on behalf of a second or the next-level step-down subsidiary of an Indian entity does not require the Reserve Bank of India's approval. It is now under the automatic route.

- Deferred payment –Regulation 7 of OI Regulations now allows acquiring equity capital in a foreign entity on a deferred-payment basis. This was earlier under the approval route.

- Disinvestment – Full disinvestment is permitted to transferor only when there are no equity/debt outstanding dues and transfer must have stayed for atleast one year from the date of making ODI.

- In addition, the new regime has introduced the concept of ‘strategic sector’, which gives the government the powers to permit overseas investment in excess of the limits prescribed under the rules.

- *Overseas Investments by Resident individuals* - Resident individuals can acquire foreign securities (subject to overall ceiling) under LRS, by:
  (a) remitting money and investing through OPI, including reinvestment;
  (b) remitting money and investing through ODI, albeit only in an operating company (not engaged in financial services) and with no subsidiary if the individual has control over the foreign entity. Such conditions are not applicable in case of ODI pursuant to inheritance,

  Resident individuals can undertake ODI or OPI only in accordance with the New Overseas Investment Regime. Only where it is specifically stated that the monetary limits prescribed under LRS shall be applicable, such limits shall apply to the relevant investments.

  Any gift of foreign securities from a person resident outside India to an individual resident in India is permitted only in accordance with Foreign Contribution Regulation Act (‘FCRA’). and the rules and regulations made thereunder. We are awaiting clarification on the compliances required to be fulfilled under the FCRA.

JMP Insights: *In light of increasing the ease of doing business in India, the Government has New Overseas Investment Regime has liberalised a few important areas concerning overseas investments. The New Overseas Investment Regime has provided clarity in many areas which were not clear in the erstwhile regime. Any Indian entity/person resident in India contemplating to make investment outside India would need to evaluate these regulations in detail including prescribed compliances.*

DID YOU KNOW?

CBDT has notified that the due date of filing Form 67 for claiming foreign tax credit has been extended to 12 months from the end of the relevant FY. Earlier, Form 67 was required to be filed on or before the due date for filing return of income of the relevant FY.

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

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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 and policy foresight and are also 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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