# 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 September 2022:

## *Insolvency and Bankruptcy Code ruling*

- **Resolution plan under the Insolvency and Bankruptcy Code, 2016 ('IBC, 2016') which does not consider statutory dues payable to State Governments or legal authorities is liable to be rejected**

  - State Tax Officer (1) v. Rainbow Papers Limited ['Supreme Court ('SC')] (Civil Appeal No. 1661 OF 2020 & Civil Appeal No. 2568 OF 2020)

  One of the operational creditors of the taxpayer commenced Corporate Insolvency Resolution Process ('CIRP') under the IBC, 2016. The Resolution Professional ('RP') dismissed the claims of the Sales Tax Officer on the grounds of delayed submission of the claim and did not consider such dues while preparing the resolution plan.

  The Honourable Supreme Court ('Hon'ble SC') held that the time period prescribed under the CIRP is not mandatory but only directory. It is the duty of the Income Tax Appellate Tribunal ('the Tribunal') to thoroughly examine the resolution plan and check if the same meets the criteria as laid down under Section 30(2) of IBC, 2016 which prescribes the minimum amount to be paid to secured creditors in case of CIRP. Debts owned to a secured creditor would include debts due to Government/statutory authorities.

  The Committee of Creditors ('COC') cannot secure their own dues at the cost of statutory dues or any other dues.

  ***JMP Insights*** *– This is a landmark decision wherein the Hon'ble SC has laid down the paramount importance of considering the pending dues of the statutory authorities towards unpaid taxes prior to acceptance of a resolution plan by the adjudicating authority.*

  *The Hon'ble SC categorically stated that any resolution plan which ignores the debts which are payable to the Government cannot be said to be in conformity with the provisions of the IBC and is liable to be rejected. However, this would result in Government dues being treated at par with workmen's dues and dues to secured creditors.*

### *Income tax rulings*

- **Eligibility to receive income tax refund in virtual bank account in absence of a valid bank account in India**

  - M. Tech Holdings PTE Limited v. The Assistant Director of Income Tax, Central Processing Unit ('CPC') [Karnataka High Court ('HC')]

    [Writ Petition No. 14924 of 2022 (T-IT)]

  The taxpayer filed a writ petition before the Karnataka HC for non-credit of refund in its foreign bank account despite determination of refund as per intimation under section 143(1) of the Income tax Act, 1961 ('the Act').

  After the writ petition was filed by the taxpayer, the CPC sent an email to the taxpayer explaining that the functionality to validate foreign bank account is not yet deployed by the Income tax Department on the e-filing portal. Hence, in the absence of a validated Indian bank account on the portal, the Income tax Department is unable to issue refund.

  In these circumstances, the CPC suggested the taxpayer open a virtual bank account in India and get it validated from the Income Tax Officer ('ITO'). Upon successful validation, CPC will then issue the refund to the said virtual bank account.

  ***JMP Insights** – The Karnataka HC decision is a welcome judgement for those taxpayers who are either foreign nationals or foreign companies who do not have an Indian bank account and are not able to receive the refund in their foreign bank account.*

- **Similarity of functions and similarity of products to be considered for selecting comparables while determining Arms Length Price ('ALP')**

  - Afton Chemical India Private Limited, Hyderabad v. ITO
    [ITA No.1467/Hyd/2019]

  The taxpayer is engaged in the business of distribution of petroleum and lubricant additives in India and also providing marketing support services to its Associate Enterprise ('AE') based in UK.

  The taxpayer challenged the inclusion of three comparables namely A, B and C by the transfer pricing officer while determining the ALP.

  The Hyderabad Tribunal noted that the taxpayer and A both are engaged in sale of specified oils. There is a difference between dissimilarity of functions and dissimilarity of products. The functions performed by both the taxpayer and A are similar, namely distribution of products. Therefore, the Tribunal held that the stand taken by the ITO to consider A as a comparable for arriving at the ALP is justified.

As regards B, the Hyderabad Tribunal noted that both the taxpayer and B are in the distribution business, taxpayer dealing with petroleum additives and B dealing with speciality chemicals. However, the Tribunal verified the Profit and loss account of B and observed that 10% of the revenue earned by B comprised of management fees and commission and the balance income comprised of sale of traded/finished goods. As against this, the segmental information in the annual report of B mentioned that the entire revenue is from one segment only, without any further details. On this basis, the Hyderabad Tribunal held that comparable B should be excluded while determining the ALP.

As regards the entity C, the total revenue from operations is from sale of traded goods. The details of the traded goods describe the products as additives, lubricants and car care products. The traded goods relate to the consumables of the automobile sector.

The Hyderabad Tribunal stated that the distinction between similarity of functions and similarity of products has to be kept in mind and an entity which is predominantly in the business of sale of the products that are sold by the taxpayer also, merely because C is selling some other type of the consumable of the same field, it cannot be said that such an entity is dealing with diversified functions and is expected to maintain segment details for each and every product separately.

- **Dutch entity not liable to withholding tax on interest on income tax refund by invoking Most Favoured Nations ('MFN') clause to extend the benefit under India-Italy Double Taxation Avoidance Agreement ('DTAA').**

  - M/s Koninklijke Philips N.V v. Deputy Commissioner of Income Tax (IT) (ITA Nos. 437 to 441/Kol/2021)

The taxpayer, a Dutch Company, received interest on income tax refund from the Income tax Department after deduction of withholding tax. The Dutch Company claimed that such interest was not taxable in India and filed an appeal before the Kolkata Tribunal.

The taxpayer has placed reliance on the MFN clause under the India-Netherlands DTAA whereby the beneficial provisions of India-Italy DTAA are applicable to it. The Madras High Court in the case of Ansaldo Energio SPA has held that interest on income tax refund is a 'debt-claim' payable by the government in terms of the 'interest' article under India-Italy DTAA. Thus, such interest was not taxable in India.

Further, based on various High Court judgements, the Kolkata Tribunal has held that protocol is an integral part of the DTAA under consideration and carries the same binding force as the MFN clause therein. No separate notification is required for applicability of the provisions of the protocol. Thus, the Kolkata Tribunal agreed with the taxpayer and held that the taxpayer was not subject to tax on such interest income in India under the Dutch DTAA.

***JMP Insights** –There have been various contradictory judgements with regards to time frame for applicability of MFN clause. The CBDT vide Circular No 3/2022 dated 3 February 2022 has clarified its position on various aspects pertaining to applicability of* *the MFN clause. One of the aspects covered in the circular is that the benefit of the MFN clause can be invoked only after it is notified by the CBDT.*

*This position is contrary to the view taken by Delhi High Court in the case of Steria India Limited which states that as the DTAA between the two countries has been notified by the Central Government, the Protocol signed by both the parties of the DTAA forms an integral part of the Convention. There is no need for the Protocol to be notified separately for resorting to the MFN clause. In the given case, the Kolkata Tribunal has relied on the aforesaid Delhi High Court ruling, which is currently pending before Supreme Court.*

- **Premium paid by India insurer to non-resident reinsurers not liable to tax in India**

  - Assistant Commissioner of Income Tax, Large Taxpayer Unit, Chennai v. M/s. United India Insurance Co. Ltd. (Chennai Tribunal)
    [ITA Nos: 1673, 1688, 1689, 1691/Chny/2011 & ITA Nos: 1693/Chny/2011, 36/Chny/2014 & 696/Chny/2014]

The taxpayer paid reinsurance premium to the Non-Resident Reinsurers ('NRR') without deduction of tax. The ITO disallowed the expenses claimed for non-withholding of tax.

The Chennai Tribunal has allowed the case in favour of the taxpayer based on the following arguments -

(i) Reinsurance premium received by the NRR is taxable in India provided the income is received/accrued/deemed to have been accrued in India. The majority of the premium payment due to NRR outside India is made through non-resident brokers or into the NRR's foreign bank account.

(ii) The only activity involved in reinsurance contract is bearing of risk. The activity of indemnifying an Indian insurance company by NRR takes place overseas and hence the risk is borne abroad. Thus, reinsurance premium paid to NRR cannot be said to be accrued in India.

(iii) The brokers involved in the transaction are merely acting as a facilitator or communication channel and do not play a principal role in conclusion of the contract or negotiating the terms of the contract. Further, the brokers do not have the authority to conclude contracts on behalf of NRR. The brokers act in their independent capacity and are neither agents of the taxpayer nor agents of the NRR. The amount collected by broker is only in the capacity as trustee and same needs to be kept in a separate bank account. Thus, the brokers cannot constitute business connection of the foreign re-insurer in India.

(iv) The signing of a reinsurance treaty either in India or outside India cannot be the basis to conclude that the income is deemed to accrue in India. Further, income of NRR is said to have deemed to accrue in India if the same arises out of business connection in India and the business operations are carried out in India through a fixed place of business in India.

The NRR is expressly prohibited to carry on business in India under the Insurance Act, 1938.The reinsurance arrangement between Indian insurer and NRR is on a principal to principal basis and in such scenario; there is no question of any business connection in India.

(v) The NRR can avail the benefit of DTAA wherein the reinsurance premium being business profit is subject to tax in India only if the NRR has Permanent Establishment ('PE') in India. The broker acting on behalf of NRR is economically and legally independent and hence in absence of being a dependent agent, NRR cannot be said to have an agency PE in India.

The withholding of income tax on payments made to NRR gets attracted only if the income is subject to tax in India. The Chennai Tribunal has concluded that the premium is not taxable in India and therefore the question of any withholding tax does not arise. Where there is no withholding obligation, there is no question of any disallowance for the reinsurance premium paid for not withholding taxes.

***JMP Insights*** *– The Chennai Tribunal decision in the given case refers to a letter dated 7 May 2008 by the Insurance Regulatory & Development Authority of India ('IRDAI') to Central Board of Direct Taxes ('CBDT') wherein it has been stated that NRR having reinsurance arrangements with Indian insurers do not have a PE or branch in India. In respect of reinsurance arrangements with brokers, IRDAI has stated that brokers are not agents of NRR and carry out transaction on a principal to principal basis.*

## *Notification*

- **Key Revised Guidelines for Compounding of offences under the Act**

On 16 September 2022, the CBDT vide F.No. 285/08/2014-IT (Inv.V)/196 has issued revised guidelines for compounding of offence under the Act to simplify and facilitate compounding of offences which are covered under the prosecution provisions of the Act.

The key points of the guidelines are as under:

- An offence committed by way of fraudulently removing, concealing, transferring or delivering to any person, any property or any interest therein, intending thereby to prevent such property or any interest therein from being attached for recovery of taxes due to the Revenue, is now compoundable.

- The time limit for acceptance of compounding application has been relaxed with the approval of Chief Commissioner of Income tax from the earlier time limit of 24 months to 36 months. In such cases where relaxation has been provided, compounding charges would be 1.5 times more than the normal compounding charges.

- If the compounding application is found acceptable, the period for payment of compounding charges can be extended by the specified authorities upto 6 months instead of 3 months and the regional authorities can extend it upto 12 months.

- Interest on delayed payment of compounding charges has been decreased to 1% per month from 2% per month for delay upto 3 months and 2% per month from 3% per month beyond 3 months.

**DID YOU KNOW?**

As per CBIC notification dated 1 August 2022, w.e.f 1 October 2022, e-invoicing shall be mandatory for businesses having turnover over INR 10 Crore in any previous Financial Year from Financial Year 2017-18 to 2021-22.

As per further recommendations from the GST Council, businesses with annual turnover of over INR 5 Crore will be required to issue e-invoice w.e.f 1 January 2023. However, no official notification has yet been released by the Authorities.

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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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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