WIRC–Questions of Brain Trust

Mumbai

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Question 1

Question in brief:

Whether Indian Companies placing advertisements on sites like Facebook, Google etc. (which are non-residents) are liable to deduct TDS u/s 195 on such payments? If yes, how to deduct TDS as these websites do not allow any reduction in payments and their PAN is also not available with the payer.

Answer

Scenario Prior to 1-6-2016

- Online advertising fees paid to foreign search engine company does not amount to Royalty/FTS. Therefore it will be treated as business income of the foreign company. If such company does not have a PE or business connection in India, the said income will not be taxable in India
  - **Right Florists (P.) Ltd (2013) (143 ITD 445) (Kol)**
  - **Yahoo India (P.) Ltd (2011) (140 TTJ 195) (Mum)**
  - **Pinstorm Technologies (2012) (154 TTJ 173) (Mum)**
  - **Ebay International AG (ITA No. 6784/M/2010) (Mum) dated 21 September 2012**
- If such foreign company has a PE in India, then the said payments will amount to business income of the NR and will be taxable in India and accordingly, taxes will have to be withheld. Since these websites do not allow any reduction in payment, the tax will have to be grossed up by the payer and it will have to bear the tax. Indian Companies however, can file an appeal u/s 248 and claim refund.
- Where the foreign company does not have a PAN, the tax shall be deductible at a higher rate as per section 206AA. However, deduction at such higher rate will not be necessary, if prescribed details under rule 37BC are obtained from the foreign company.

Question 1 (Contd..)

- If the foreign company has a PE in India and the payments are treated as Royalty/FTS, section 44DA may get triggered if the right/property/contract in respect of which Royalty/FTS are paid is effectively connected with such PE; and accordingly, the income will be computed under 'Profits and Gains of Business or Profession'

- **The decision in case of Google India (P) Ltd. (93 taxmann.com 183) (Bang) is distinguishable on facts**
  In case of Google India, Indian entity made payment to Irish entity for purchasing of advertisement space under Google-USA's Adwords programme for resale to advertisers in India as also for post-sales services that included usage of trademarks, IPRs, brand features, derivative works and other intangibles owned by Irish company GIL, consideration so paid was treated as 'Royalty' liable to tax under section 9(1)(vi)

Scenario after 1-6-2016

- As per the amendment made by Finance Act 2016, payment made by a resident carrying on business profession to a non-resident, an Equalization Levy @6% shall be deductible, if the aggregate amount exceeds Rs. 1 lakh.
- It is to be noted that no tax credit is available to the payee in its home country, of such Equalization Levy paid in India

Question 2

Question in brief:

Where AO had raised queries on a particular issue and passed an assessment order without making an addition, can jurisdiction u/s 263 be invoked on the ground that AO did not carry out proper inquiry?

Answer

- For invoking jurisdiction u/s 263 the order passed by the AO must be: (i) Erroneous and (ii) Prejudicial to the interest of the Revenue. Both the conditions should be cumulatively met. Powers u/s 263 can be exercised, if and only if order passed by the AO is not sustainable under law.
- If there is a lack of inquiry resulting into error of facts or law and if such order is not sustainable in law, CIT is justified in invoking powers u/s 263 of the Act. **Malabar Industrial Co. Ltd. vs. CIT (2000) (243 ITR 83)(SC)**
- Bombay HC in **Gabriel India Ltd.(203 ITR 108)** held that order cannot be held as erroneous simply because the AO dis not make elaborate discussion
    - **Nirav Modi (2016) (390 ITR 292) (Bom)** (SLP against HC decision dismissed by SC in 244 taxman 194)
- In the case of **CIT Vs. Sunbeam Auto Ltd (2011) 332 ITR 167 (Del)** it was held that one has to keep in mind the distinction between 'lack of inquiry' and 'inadequate inquiry'. If there was any inquiry, even inadequate that would not by itself give occasion to the Commissioner to pass orders under section 263, merely because he has different opinion in the matter
- Amendment made by **Finance Act 2015** by way of insertion of Explanation 2 does not really change the position as laid down by the courts, as it covers orders passed '*without making inquiries or verifications*' which ought to have been made.

Question 3

Question in brief:

Whether in case of slum sale/ amalgamation/ demerger, the resulting/ successor company is eligible to claim expenses on payment basis which was disallowed in the hands of the demerged company u/s 43B?

Answer

- In case of **KEC International vs. ACIT (41 SOT 43) (Mum)** the assessee claimed that expenses in respect of which disallowance was made u/s 40(a) and u/s 43B in the hands of the demerged company in earlier years, should be allowed to the assessee since the payments were made by it during the year. ITAT held that since the expenditure was allowable on actual payment basis, it had to be allowed to the transferee.

- In case of **slump sale**, it is possible to take a view that deduction can be availed by the successor entity on actual payment, if the undertaking is transferred as a going concern with all assets and liabilities pertaining to it satisfying conditions of section 50B. In such case one may take a view that since liabilities of the undertaking are transferred to the successor entity, it is eligible to claim deduction on discharge of liability.

  - Alternatively, where the payment is made by successor entity before the due date of filing the return of income, deduction can be availed by the predecessor entity, since the actual payment made up to the date of ROI virtually relates back to year of incurring expenditure and thus enables the entity incurring the expenditure to claim the deduction in respect of the same. If the payment is made beyond the due date of ROI, deduction may be allowable to the successor entity.

Question 3 (Contd..)

- Reliance can be placed on the decision of the SC in **CIT vs. Veerbhadra Rao (155 ITR 152) (SC)** where the Court allowed deduction in respect of bad debt write off to the successor entity even though the debt was incurred by the predecessor entity.
  - Times Business Solution Ltd. (2013) (354 ITR 25) (Del HC)

- Reliance may be placed on the following decisions, where benefit of deduction u/s 80-IB, 10AA etc. was allowed to the successor entity for the unexpired period:

  - **Wrigley India (P) Ltd. (142 TTJ 23) (Del)**
  - **Tyresoles Concessionnairs P. Ltd. 213 ITR 660 (Bom)**
  - **Hindustan Petrolium Corp. Ltd. 16 ITD 574 (Bom)**
  - **IIS Infitech Ltd. (2003) 82 TTJ 174 (Del tribunal)**

- However in case of **Amalgamation** where the predecessor entity ceases to exist after amalgamation, the issue may require different consideration
  - It may be contended that since the predecessor entity ceases to exist, the deduction has to be allowed in the hands of the successor entity, as otherwise even after actual payment by successor, the deduction will stand frustrated and nobody will get the deduction
  - It is possible that a stand may be taken by the Revenue that section 43B refers to the term “assessee” and since the assessee who has incurred the expenditure ceases to exist, the expenditure is not allowable. However, reliance could be placed on the above mentioned decision of SC in Veerbhadra Rao (155 ITR 152)

Question 4

Question in brief:

Capital gains on transfer of shares of an Indian company acquired before April 1, 2017 by a tax resident of Mauritius / Singapore are exempt under the respective tax treaties subject to fulfilment of conditions specified under the 'Limitation of Benefits' clause. Will such benefit be available on transfer / issue of shares under the following scenarios:

(i) Shares received on merger / demerger of the company in which investment was made before April 1, 2017
(ii) Bonus Shares
(iii) Shares Subscribed under Right Issue
(iv) Shares acquired by way of a gift exempt under section 47 of the Act

Answer

i. Since the shares acquired under merger/demerger after 1-4-1017 are acquired by virtue of holding some shares which were acquired before April 1, 2017, it is possible to take a view that gains arising on transfer of shares acquired under the scheme of merger/demerger will be eligible for Treaty benefit
ii. In case of Bonus shares acquired after 1-4-2017 where the original shares were acquired before the said date, it is possible to take a view that capital gains on transfer will be eligible for Treaty benefit
iii. It is a debatable question whether capital gains on transfer of shares acquired after 1-4-2017 under a rights issue can be claimed exempt under the Treaty, even tough such rights originated from shares held prior to 1-4-2017
iv. If the shares are acquired by the donor before 1-4-2017 and have been gifted to the donee after the said date, it may be possible to take a view that capital gain in hands of the donee on transfer of such shares will be eligible for Treaty benefit as date of acquisition relates back to date of acquisition by Donor.

Question 5

Question in brief: Taxability of Reimbursement of- Salary / Remuneration of an Expatriate/ Seconded Employee:

The issue of taxability of reimbursement of salary/ remuneration of an expatriate employee on secondment / deputation/ assignment by a parent company or an associate enterprise has become controversial due to divergent judicial pronouncements. The tax department is taxing the same as FTS in the hands of the parent company / associated enterprise (‘AE’), though there is no mark up and appropriate tax is deducted from the salary of the expatriate employee.
What is the correct view? How should such an arrangement be structured to avoid controversy?

Conclusion

- Issue of taxability will depend on whether the parent company/ AE is deputing/ sending on secondment / assignment for rendering services on behalf of parent company/ AE or working as employee of Indian Company

- Payment to non-resident towards reimbursement of salary for seconded/ assigned employees not fees for technical services

    - Morgan Stanley International Inc (ITA No. 6882/Mum/2011) dated 18 December 2014
    - Marks & Spencer Reliance India Pvt Ltd (dated 4 September 2013)
    - Temasek Holding Advisors (I) Pvt Ltd (dated 30 August 2013) (Mumbai Tribunal)

Question 5 (contd…)

- There are several contrary rulings on the said issue wherein the payment is not treated as reimbursement but it is fees for services rendered.
  - Centrica India Offshore Private Ltd – AAR - [249 CTR 11] [Against view taken] **approved by Delhi HC (364 ITR 336) (May 2014) and SLP dismissed by Supreme Court**
  - Target Corporation India Ltd - [252 CTR (AAR) 242] [Against view taken]
  - Verizon Data Services India Ltd [337 ITR 192] - set aside by Madras HC [WP No 14921 of 2011 dated 14 Nov 2011]

- Issue of PE of Foreign PE being created is also raised by some of the AO. Defense in that case could be that claim salary paid to ex-pats as deduction, while computing the income of PE in India

  - Centrica India Offshore Private Ltd – AAR - [249 CTR 11] [Against view taken] approved by Delhi HC (364 ITR 336) (May 2014) and SLP dismissed by Supreme Court
  - Morgan Stanley (153 ITD 403) (Mum)

- In view of the conflicting rulings and to put at rest, the stir created by such rulings, concrete clarification from the legislature is required.

Question 6

Question in brief:

Is indexation benefit available on sale of listed debentures in view of first proviso to section 112 r.w. fourth proviso to section 48?

Answer

- Assessee can opt for either 10% rate of tax under proviso to section 112 without indexation benefit or for 20% rate of tax with indexation under second proviso to section 48

- Benefit of indexation, however, is not available on debentures, irrespective of whether listed or unlisted, as per fourth proviso to section 48

- Therefore in case of listed debentures only option available to the assessee is to apply 10% tax rate on capital gains without taking benefit of indexation.

- Reference can be made to the decision of Delhi HC in Cairns UK Holdings Ltd. (359 ITR 268) for detailed analysis of section 48 and section 112 regarding indexation, rate of tax etc.

Question 7

Question in brief:

As per the provision relating to amalgamation which reads as under "Shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation."

Three Companies say A Ltd, B Ltd and C Ltd. are closely held companies. B Ltd. and C Ltd. are getting merged with A Ltd. through one scheme of amalgamation. The shareholding pattern of the aforesaid Companies is given below:

Shareholders of A Ltd	Shareholders of B Ltd	Shareholders of C Ltd
Promoters – 90%	A Ltd. – 50%	A Ltd. – 30%
B Ltd. – 5%	C Ltd. – 45%	B Ltd. – 30%
C Ltd. – 5%	Others – 5%	Others – 40%

Whether this will qualify as tax compliant amalgamation or not?

Answer:

Shares already held by A Ltd. in B Ltd. and C Ltd. are to be excluded for the purpose of computing the percentage of shareholders who become shareholders of amalgamated company. When shares already held by A Ltd. are excluded, remaining 100% shareholders are becoming the shareholders of A Ltd. Therefore, the amalgamation is tax compliant

Question 8

Question in brief:

Whether the condition prescribed u/s 72A(2)(a)(ii) for permitting carry forward off loss and depreciation in course of amalgamation is with regards to the value of the assets or identity of the assets?

Answer

Text of Section 72A(2)(a)(ii) is reproduced for reference as under:

"..(ii) has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation"

Section 72A(2)(a)(ii) can be interpreted in following manner:

- Language of the section is very clear and it refers to "book value" of the assets. Therefore, identity/number of assets would be irrelevant for the purpose of this section.
- For computing book value of the assets held by amalgamating company as on the date of amalgamation as compared to what it was holding two years prior to amalgamation, recent additions made to the assets within two years are to be ignored.
- A view is expressed that 'book value' for the purpose of this section would mean the gross value/ cost of assets without deducting depreciation
- Where there are more than one amalgamating companies, condition is to be examined qua each company, and non-compliance by one entity does not impact transition of losses of other compliant entity

Question 9

<u>Question in brief:</u> When land owner enters into development agreement with builder, whether benefit of Section 45(5A) can be availed? If part completion certificate is issued, whether proportionate capital gain ought to be taxed?

<u>Answer</u>

- Section 45(5A) introduced by FA 2017 w.e.f. 1 April 2018 - introduced to provide the point of taxation for individuals and HUFs entering into Joint Development. The capital gains shall be chargeable to tax in the previous year in which certificate of completion for the **<u>whole or part of the project</u>** is issued.

- Prior to insertion of section 45(5A), capital gain is chargeable to tax in the year in which transfer takes place except in certain cases. The definition of 'transfer', inter alia, includes any arrangement or transaction where any rights are handed over in execution of part performance of contract, even though the legal title has not been transferred. In such a scenario, execution of Joint Development Agreement between the owner of immovable property and the developer triggers the capital gains tax liability in the hands of the owner in the year in which the possession of immovable property is handed over to the developer for development of a project.

Question 9

- This amendment overcomes the controversy created by the decision of the Bombay High Court in the case of **Chaturbhuj Dwarkadas Kapadia vs Commissioner Of Income-Tax, (260 ITR 491)(Bom)** wherein it was held that tax liability triggers on the transfer – date of the contract between the parties.

- The tax liability will arise either when certificate of completion is received either wholly or in part. Even for part certificate issued, tax liability for the whole will get triggered.

Question 10

Question in brief: **Determination of date of transfer of Tenancy rights. Full value of consideration due to assessee on transfer of tenancy. Taxability of Capital Gain in a case where, tenant is not eligible to claim exemption under section 54F since he already owns 2 houses.**

Answer

Date of transfer of Tenancy rights would be, *the* date on which the tenant moves into an alternative accommodation so as to enable the landlord to demolish the building and construct new building;

Full value of consideration due to the assessee on transfer of tenancy against flat on ownership basis, would be the market value of the asset/ premise at the point of time when the tenancy rights were transferred. This will be cost of new flat plus additional amount paid.

Reference can be made to following decisions on this subject:

- Mrs. Tauqeer Fatema Rizvi – Mumbai Tribunal [ITA no. 8862/Mum./2011 dated 2 May 2014] – **distinguished by Jayantilal Jain (ITA No. 1125/M/2015) dated 31 July 2017**
- Balmukund P Acharya v/s ITO [45 DTR (Mum.) (Trib.) 281];
- CIT v/s George Henderson & Co. Ltd., [66 ITR 622 (SC)];
- CIT v/s Abrar Alvi, [247 ITR 312 (Bom.)];
- Atul G. Purnaik v/s ITO, [132 ITD 499 (Mum.)]

Question 10

- **D.P. Sandu & Bros. Chembur Pvt Ltd (273 ITR 1) (SC) -** Consideration for surrender of tenancy rights was not chargeable under section 45 prior to amendment of section 55(2) in 1995 as its cost of acquisition could not be determined as agreed by Revenue; said receipt not being chargeable under section 45 because of inapplicability of computation provision, cannot be treated as a casual and non-recurring receipt under section 10(3) and be subjected to tax under section 56.

- If tenant does not pay within 30 days of being called by Developer, then he can occupy flat of tenant. In such situation, there will not be any “transfer” of tenancy right for exchange with ownership right. No capital gains issue can arise.

- Point for consideration is can date of transfer be deferred till Developer makes “call for payment” (which is date to determine whether he will continue to be tenant or he will exchange for ownership flat) and not date of shifting to alternate accommodation.

Question 11

Question in brief:

What is the validity of Notice u/s 148 when company is converted to LLP and notice is issued in the name of the company?

Answer

- **Reassessment framed pursuant to notice under section 148 in the name of the assessee company which was non-existent as on the date of issue of notice is null and void,** provided conversion of company to LLP is intimated to AO**.**

- **Neha Enterprises (ITA No. 3666/M/2015) dated 20 December 2017:**
  Assessee firm was converted into a private limited company on 20-2-2008 and the notice for re-opening of the assessment for the AY 2007-08 was issued on 27-2-2012 in the name of the firm which was non-existent as on the date of issue of notice under notice 148 of the Act. Hence issue of notice u/s 148 is null and void.

Question 11

- **Notice issued on dead person or a non-existent firm/person is bad in law:-**

  - M/s DLF Cyber City Developers Limited [53 taxman.com 81]
  - Spice Infotainment Ltd (ITA 475 & 476 of 2011) (Delhi HC) affirmed by Supreme Court in Civil appeal 285 of 2014

- **Assessment on dissolved/amalgamated company is bad in law:-**

  - Jitendra Chandralal Navlani & Anr [Writ Petition No. 1069 of 2016 (Bom) dated 8 June 2016
  - DSP Merillynch Ltd (ITA No 5331/M/2014) dated 9 May 2017 (Mumbai Tribunal)
  - Siemens Technology Services Pvt Ltd (ITA 6313/M/2012) dated 16 November 2016 (Mum)

- **Intimation to given about the change in entity**

  - M/s DLF Cyber City Developers Limited [53 taxman.com 81]
  - Dimension Apparels (P.) Ltd (370 ITR 288) (Delhi Trib)]

Question 12

Question in brief:
Implications under section 56(2)(viia) of gift of shares by one company to another company?

Answer

- As per the Explanatory Memorandum to the Finance Bill 2010, clause (viia) was inserted with effect from June 01, 2010 in section 56(2) to prevent the practice of transferring shares of a closely held company without consideration or at a price lower than the FMV; to be determined in accordance with prescribed valuation rules.

- As per section 56(2) (viia), any receipt of shares of a closely-held company (closely held shares), without consideration or for inadequate consideration, is taxable in the hands of the recipient company; consideration would be deemed to be inadequate, if the difference between the actual consideration and the FMV (to be determined as per prescribed Valuation Rules) of the property exceeds Rs.50, 000. Rule 11 UA of the Income Tax Rules 1962 prescribes valuation rules for unlisted equity shares (at Book Value of assets upto 29 November 2012) and other securities. (Rule 11UA modified to take market value of underlying assets w.e.f 29 November 2012)

Question 12

- W.e.f. 1 April 2017, section 56(2)(x) has been inserted, making “gift” provisions applicable to all companies.

- Prior to the insertion of section 56(2)(viia), gifts were held to be non taxable, under section 56(2).

  - **DP World Pvt Ltd (140 ITD 694) (Mum) -** Gift of shares of an Indian Company by a foreign company without consideration has to be treated as gift within the meaning of Section 47(iii) of the Act and thus is a capital receipt not chargeable to tax.

  - **Redington India Ltd (40 CCH 527) (Chn) -**Transfer of shares made by assessee company/Corporate entity to its step down subsidiary without consideration is a valid gift and cannot be regarded as transfer of capital asset for purpose of capital gains taxation, as provided in section 47(iii).

- It will not make any difference, even if shareholders of both companies are common or relatives, as company is a separate legal entity.

Question 13

Question in brief:

AO made addition u/s 68 in respect of share application money received by the assessee in the very first year of its incorporation. Whether AO could have made such addition in spite of the fact that assesse had practically done no business so as to generate any such income? What proof is required for proving the genuineness of the transaction? What shall be the scenario where share application money is received from tainted entities? What is the effect of finding that promoters/ directors of assessee-company later on acquired the very shares at discounted rates from such share-holders?

Answer

Refer amendment to Section 68 by way of proviso inserted w.e.f. 1 April 2013, about shifting of onus of proof on the company in case the shareholders are not able to prove the nature and source of investment.

Prior to the amendments when onus was on AO:-

- **Lovely Exports Pvt Ltd (216 CTR 195) (SC)**
- **Stellar Investment Ltd (251 ITR 263) (SC)**
- **Five Vision Promoters Pvt Ltd (380 ITR 289) (Del HC) dated 27 November 2015 after considering Sophia Finance**
- **Pranav Foundations Ltd (117 DTR 227) dated 12 August 2014**

(Post amendments the onus is shifted on the company)

Question 13 (Contd..)

Amendment to section 68 is prospective and not retrospective

- Gagandeep Infrastructure (394 ITR 680) (Bom)

- The Hon'ble High Court in Five Vision referred to the full bench decision in case of **Sophia Finance Ltd (205 ITR 98) (Del HC) dated 27 August 1993** in the context of section 68 wherein it has been held that the assesse company has to prima facie prove:
  - the identity of the creditor/subscriber;
  - the genuineness of the transaction, namely, whether it has been transmitted through banking or other indisputable channels
  - the creditworthiness or financial strength of the creditor/subscriber

- Also refer **Rajmandir Estates Pvt Ltd (386 ITR 162) (Cal) dated 13 May 2016** for the cases of tainted transactions - Mere fact that payment was received by cheque or that applicants were companies, borne on file of Registrar of Companies were held to be neutral facts and did not prove that transaction was genuine.

Question 14

Question in brief:

What is the treatment of gifts received by HUF from its members or their relatives?

Answer

- The earlier definition of "relative" in Explanation (e) to Section 56(2)(vii) of the Act did not consider member as a relative.

- The amendment of Finance Act 2012 (Explanation (e) to Section 56(2)(vii) of the Act (w.r.e.f 1 October 2009) specifically exclude the gifts received by HUF from its members (Explanation (e) to Section 56(2)(vii) of the Act.
- **Before amendment of Finance Act 2012**

HUF is 'a group of relatives' and a gift received from "relative", irrespective of whether it is from a member or individual relative or from a group of relatives is exempt from tax under the provisions of section 56(2)(vi) of the Act.

- **Harshadbhai Dahyalal Vaidhya (HUF) Vs. ITO (88DTR288)(Dated 26 April 13)(Ahmedabad Tribunal)**
- **Vineetkumar Raghavjibhai Bhalodia vs. ITO reported at (2011) 140 TTJ 58(Dated 17 May 2011) (Rajkot Tribunal)**

Question 15

Question in brief:

Whether clubbing provisions of section 64(2) can be said to be applicable in respect of sum on money received without consideration?

Answer

- The provisions of section 64(2) is applicable to income of HUF from property converted by the individual into HUF property. Explanation to the section provides that the word "property" includes any interest in property, movable or immovable, the proceeds of sale thereof and any money or investment for the time being representing the proceeds of sale thereof and where the property is converted into any other property by any method, such other property.

- The provisions of section 64(1) include wordings 'assets transferred'. The explanation to section 64(2) defining the word 'property' includes interest in property, "**movable or immovable".**

- Therefore sum of money received without consideration should be included in 'property' referred to in section 64(2).

THANK YOU