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 February 2025:

Income tax rulings

- **Directing CBDT to modify utilities for filing return to allow claiming rebate under Section 87A**

  - The Chamber of Tax Consultants vs Union of India[1]

The Chamber of Tax Consultants ('CTC') in conjunction with concerned taxpayers, has initiated the Public Interest Litigation ('PIL') to address the unilateral modification of the e-filing utility software by the Tax Department. This modification, effective from 5 July 2024, unilaterally precluded taxpayers from claiming the rebate under Section 87A of the Income Tax Act, 1961 ('the Act') on income taxed at special rates, in cases where the taxpayers opted for the new regime under Section 115BAC of the Act.

It was contended that this change is legally untenable. The CTC emphasizes that the legislature has explicitly delineated instances where the benefit of Section 87A of the Act is to be denied for specific income. Notably, Section 112A(6) of the Act stands as the sole provision containing such a prohibition, reinforcing the implication that the rebate remains applicable to other specially taxed incomes.

A core argument presented by the CTC hinges on the fundamental principle that the income tax return form must facilitate taxpayer's ability to self-compute their income and tax liabilities based on their belief and understanding. The CTC posits that the statutory entitlement conferred by the proviso to Section 87A of the Act cannot be arbitrarily curtailed through mere modifications to the e-filing utility software.

Further, it was argued that not allowing the taxpayer to make the claim and thereby seeking more taxes would violate the fundamental rights guaranteed under the provisions of Constitution of India.

The tax authorities contended that, the legislative intent behind Section 115BAC of the Act, which promotes simplified taxation and lower tax rates by forgoing deductions and exemptions, dictates that the rebate under Section 87A of the Act should apply exclusively to the tax computed under Section 115BAC of the Act. They argued that this rebate is not applicable to tax calculated under any other provision within Chapter XII of the Act. This position is grounded in the explicit wording of the proviso to Section 87A of the Act.

[1] Public Interest Litigation (L) No.32465 of 2024

The HC acknowledged the complexity of the issue, stating that the provision of the Act was not sufficiently clear to justify that rebate under Section 87A of the Act cannot be granted from the tax computed under other provisions of Chapter XII. The HC emphasized that resolving this question would necessitate a detailed interpretation of various provisions within Chapter XII and Section 87A of the Act.

Furthermore, the HC highlighted that merely because many returns are required to be processed and only a few of them are selected for scrutiny cannot be grounds to prohibit a taxpayer from making a debatable and arguable claim. The HC reasoned that the inherent ambiguity surrounding these provisions should not be used to deny taxpayers the opportunity to raise such claims at the outset. Instead, the HC suggested that the debatable or arguable aspects of the taxpayer's entitlement to the rebate could be thoroughly examined during the assessment process.

The HC also underscored the fundamental principle that technology should serve to streamline the tax process, not obstruct a taxpayer's right to claim legally granted benefits or raise legitimate points of contention.

Consequently, the HC directed the Central Board of Direct Taxes ('CBDT') to immediately modify the online utilities for filing income tax returns. This modification would enable taxpayers to claim the rebate under Section 87A read with the proviso to Section 87A, in their returns for FY 2023-24 and subsequent years, including revised returns filed under Section 139(5) of the Act.

While the HC granted the petitioners request to mandate the tax authorities to modify the software to accommodate rebate claims under Section 87A of the Act, it opted to defer addressing other related issues, reserving them for consideration in future cases.

JMP Insights *– This ruling represents a reminder to the tax authorities that procedural changes such as modifications to e-filing software cannot override substantive legal entitlements. The HC's directive to the CBDT to rectify the e-filing utility underscores the necessity for fair and transparent tax administration, ensuring that taxpayers can accurately self-compute their liabilities based on their interpretation of the law.*

The Finance Minister in her Budget speech 2026 announced that there will be no income tax payable up to income of INR 12,00,000 other than special rate income such as capital gains under the new regime. However, there is no language change proposed in the provisions of Income Tax Act, 1961 as well as under the Income Tax Bill 2025, which may result in continued ambiguity and litigation.

- **Salary reimbursement of seconded employees will not be subject to withholding tax**

  - DCIT vs Flipkart Internet Private Limited[2]

Walmart Inc., Delaware USA ('Walmart Inc.') had seconded a few employees to the taxpayer vide an Inter-company Master Services Agreement ('MSA'). For administrative convenience, it was agreed that Walmart Inc. would make payment of salaries to the Seconded Employees which in turn would be reimbursed by the taxpayer. The taxpayer deducted withholding tax on salary components and remitted the net salary amount to Walmart Inc. as a reimbursement.

Dissatisfied with the ruling of Single Judge Bench directing the tax officer to issue a 'Nil' withholding certificate under Section 195(2) of the Act, the tax officer filed a writ petition before the Karnataka High Court ('HC').

The taxpayer contended inter alia that - a) Withholding tax obligation under Section 195 was not triggered in the instant case as the Salaries were pure reimbursements and had no income element embedded therein; b) the reimbursement of Salaries could not be classified as Fees for included Services ('FIS') under Article 12 of the India-US DTAA as the 'Make Available' Test was not met.

The HC relied on precedent set by a Coordinate Bench in the case of Abbey Business Services India (P) Ltd[3], affirming that the Secondment Agreement constitutes an independent contract of service between the seconded employees and the taxpayer. The HC underscored the significance of the Triple Test namely demonstration of Direct Control, Supervision and Direction, as established in Abbey supra, constitutes compelling evidence of an employer-employee relationship, even in the absence of certain ancillary indicators.

The HC highlighted the clauses in MSA, the global work assignments and the appointment letters as evidence of an employer-employee relationship. These documents, including details like job charts, provident fund contributions and visa procurement, strongly suggest that the seconded employees were effectively working for and under the control of the taxpayer.

The HC relied on the decision of De Beers India Pvt Ltd[4], which clarified that technology will be considered to be 'made available' only when the service recipient is empowered to independently apply the technology, resulting in an enduring benefit. The HC noted that the services so provided did not satisfy the 'Make Available' Test which is a sine qua non for taxability of services as FIS.

In conclusion, the HC dismissed tax officer's writ petition, thereby affirming the Single Judge Bench order. Consequently, the HC directed the tax officer to issue a 'Nil' Tax Deduction at Source certificate under Section 195(2) of the Act.

JMP Insights *– This is a welcome ruling for the taxpayers as the cost-to-cost reimbursement of salaries paid to Group company for expats have been excluded from the withholding tax ambit. However, it must be borne in mind that contractual documents play a key factor in*

[2] Writ Appeal No. 992/2023
[3] [2020] 122 Taxmann.com 174 (Kar)
[4] (2012) 346 ITR 467 (Kar)

identifying the true nature of the secondment arrangement and therefore, the applicability of withholding provisions will have to be determined on a case-to-case basis.

- **Expenses allocated to Indian PE are allowed under India UAE DTAA**

  - Mashreq Bank Psc vs DCIT[5]

The taxpayer is a non-resident banking company having its business operations in India. During FY 2001-02, the tax officer disallowed the head office expenses to the taxpayer as per the provisions of the Act. The tax officer contended that the amendments introduced in the India-UAE DTAA in 2007 were only clarificatory in nature and the restrictions for deduction of expenses were always present in Article 25 of the India-UAE DTAA. Additionally, the tax officer also disallowed certain expenditure incurred outside India.

The taxpayer was of the view that expenses allocated to permanent establishment in India should be allowed in full without any restrictions prescribed under the Act. The provisions of the Act would apply to the extent they are beneficial to the taxpayer.

The Special Bench Tribunal ('Tribunal') held that as per the pre-amended Article 7(3) of the India-UAE DTAA before amendment, there was no restriction imposed regarding the limit of expenditure to be allowed with reference to the Permanent Establishment. Accordingly, the taxpayers were eligible to claim the deduction of expenses attributable to their PE in India without any restrictions prior to the 2007 amendment. The Tribunal further rejected the tax officers' arguments relating to amendment being clarificatory in nature, thus offering a different interpretation of Article 25 vis-à-vis Article 7 of India-UAE DTAA. The purpose of Article 25 of India-UAE DTAA was to re-iterate that income should be taxed either under the domestic act or the India-UAE DTAA whichever is beneficial to the taxpayer. It cannot be interpreted to impose restrictions on the manner of computing the tax.

In relation to expenditure incurred outside India, the Tribunal held that such expenditure was exclusively related to the operations of the Indian PE and therefore, are outside the scope of 'head office expenditure' as per the Act.

Accordingly, both the grounds raised by the tax officer were dismissed and deduction for expenditure incurred was allowed to the taxpayer.

JMP Insights *– The ruling reinforces the established principle that in case of the conflicting provisions, the provisions beneficial to the taxpayer would prevail.*

- **Independent consultant providing similar services to others does not constitute Dependent Agent Permanent Establishment under the DTAA**

  - ESM Group Inc vs Deputy CIT[6]

The taxpayer is a non-resident engaged in the business of manufacturing and selling of products and equipment in relation to steel industry in the USA. The taxpayer had entered into

[5] ITA No 1342/Mum/2006 (Mumbai ITAT)
[6] ITA No 9365/Del/2019 (Delhi ITAT)

a contract with Indian parties for supply of equipment, design and engineering services, supervision services and training to personnel in India. The taxpayer had entered into a service agreement with a third party consultant for assistance in liaising with the customers in India.

The tax officer was of the view that certain clauses in the service agreement indicated control over the consultant and accordingly, the consultant formed a dependent agent permanent establishment ('DAPE') in India and taxed the income attributable to such DAPE.

The Delhi Tribunal analysed the service agreement between the taxpayer and the consultant in the light of Article 5 of India USA DTAA dealing with constitution of PE in India. The Tribunal observed that as per Article 5 of India USA DTAA, third party would be considered as a DAPE only if their activities are devoted wholly and exclusively for the taxpayer. Further, the consultant would be a PE if it habitually concludes contracts on behalf of the taxpayer.

On perusal of the contract with the consultant, the Tribunal observed that the consultant had no rights to conclude contracts on behalf of the taxpayer. The role of the consultant was primarily liaising between the taxpayer and the project partner. The consultant had entered into transactions with other parties apart from the taxpayer, evidencing that it was not dependent on the taxpayer for its finances.

Accordingly, the Tribunal ruled that the consultant would not be considered as a DAPE for the taxpayer. Therefore, consideration received on supply of equipment along with drawings and documents ancillary to such supply would not be taxable in India.

JMP Insights *– The ruling highlights the importance of drafting service agreements with third parties to avoid any tax litigation. Another important aspect to consider whether the consultant would constitute a DAPE for the taxpayer is the dependency of such consultant on the taxpayer. Consultants engaging in business with several customers may provide additional evidence on the independence of such consultants.*

DID YOU KNOW?

As per existing rules of the Companies (Prospectus and Allotment of Securities) Rules, 2014, a private company (not a small company), with financial year ending on or after 31 March 2023, was required to facilitate the dematerialisation of all its securities by 30 September 2024.

The Central Government, vide Notification dated 12 February 2025, has extended the effective date for the mandatory dematerialization of securities to 30 June 2025 for a private company (other than Producer company), which is not a small company as on 31 March 2023.

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.

We would like to take this opportunity to announce that JMP Advisors has recently been awarded **'Tax Advisory Expert of the Year in India – 2025 at the 2025 Global Advisory Experts Annual Awards'** for its outstanding services. We are proud to receive this accolade and endeavour to continue providing high quality services to our clients!

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