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 October 2024:

Income tax rulings

- **Concessional rate of 20% applicable to capital gains on depreciable assets**

    - SKF India Limited vs Deputy Commissioner of Income Tax Range 4(3)[1]

The taxpayer, SKF India Limited, a public limited company sold/transferred three residential properties during the Financial Year ('FY') 1998-1999. These properties were a part of a block of assets and the taxpayer had claimed depreciation on these properties in the prior years. In computing total income, the taxpayer calculated the excess of the sale consideration over the Written Down Value ('WDV') of the properties as Short-Term Capital Gain ('STCG') under Section 50 of the Income Tax Act, 1961 ('Act') amounting to INR 2,95,55,888. The taxpayer adjusted the carried-forward capital loss of INR 32,95,306 from earlier years against the aforesaid STCG, resulting in a net STCG of Rs. 2,62,60,582. Further, on the net STCG, the taxpayer applied the concessional tax rate of 20% under Section 112 of the Act.

The tax officer issued a show cause notice questioning the applicability of concessional tax rate of 20%, applicable to a Long Term Capital Gain ('LTCG') instead of the tax rate applicable for STCG.

The taxpayer had placed reliance on the Mumbai Tribunal ruling in case of Ace Builders Private Limited[2]. However, the tax officer rejected this reliance noting factual differences and confirming that the sale transaction squarely falls under Section 50 of the Act. Accordingly, the tax officer concluded that the capital gains should be taxed as STCG. On appeal, the Commissioner of Income-tax (Appeals) ['CIT(A)'] upheld the decision of the tax officer.

In the taxpayer's own case in other AYs, the Mumbai Tribunal had ruled against the taxpayer. Since the decision of the Mumbai Tribunal in taxpayer's own case was contradictory to the Mumbai Tribunal in case of Ace Builders Private Limited (relied upon by the taxpayer), the matter was referred to a Special Bench of the Tribunal.

Before the Special Bench of Mumbai Tribunal, the Revenue placed reliance on another ruling of Bombay High Court in the case Ace Builders Private Limited[3] pertaining to availability of exemption under Section 54E of the Act in respect of sale of depreciable assets. The Mumbai Tribunal has noted that the restriction in Section 50 of the Act is limited to the mode of computation specified in Section 48 and 49 of the Act. The Mumbai Tribunal also noted that the Supreme Court ('SC') had fully endorsed the Bombay High Court's judgment in Ace

[1] ITA No.7544/Mum/2011
[2] (76 ITD 389)
[3] 281 ITR 210 (Bombay)

Builders Private Limited, confirming that the legal fiction in Section 50(1) and (2) of the Act is limited to the computation of capital gains under Sections 48 and 49 and should not extend to other provisions of the Act.

In the case of the taxpayer, the Mumbai Tribunal noted that while most judgments address the applicability of exemption under Section 54E of the Act, in case of depreciable assets, the principles established therein will apply in the present case too, as Section 54E provides an exemption for gains from transferring “Long Term Capital Assets (‘LTCA’).” Thus, even if Section 50 deems the gains as STCG for tax purposes, it does not convert the asset itself into a Short Term Capital Asset (‘STCA’) for other provisions of the Act. Similarly, Section 112 of the Act specifies that where a taxpayer’s income includes gains from transfer of LTCA, the concessional tax rate will apply. The Mumbai Tribunal concluded that when the Act refers LTCA, it must retain the meaning defined in the relevant section.

Further, the Mumbai Tribunal observed that various other Bombay High Court rulings have upheld the offsetting of LTCL against deemed STCG of depreciable assets arising under Section 50 of the Act.

The Mumbai Tribunal also dealt with the non obstante clause under Section 50 of the Act. It stated that the non-obstante clause does not override all other provisions of the Act. It only removes obstacles that might arise from other laws affecting the primary provisions it supports. The Mumbai Tribunal re-iterated that in Section 50 of the Act, the non-obstante clause is limited to the computation method under Sections 48 and 49 of the Act.

The Mumbai Tribunal held that capital gains from a depreciable asset under Section 50 of the Act, though treated as gains from a STCA, should be confined to that section only. This fiction does not convert a LTCA into a STCA (or vice versa) for other purposes of the Act.

In a dissenting opinion, the Accountant Member noted that only LTCG from the sale or transfer of a LTCA qualifies for the concessional rate under Section 112 of the Act. Since the taxpayer classified gains from depreciable assets as STCG under Section 50 of the Act, the concessional rate cannot apply. The member emphasised that the charging section i.e. Section 50 of the Act specifically deems such gains as STCG, and thus they cannot be treated as LTCG under Section 112 of the Act which only prescribes tax rate on the gains. The member argued that allowing the concessional rate would undermine Section 50 of the Act. Accordingly, the member ruled in favour of the Revenue and against the taxpayer.

However, since two members out of three were in favour of the taxpayer, the appeal was ruled in favour of the taxpayer.

JMP Insights – *The ruling reinforces that that statutory deeming fictions in law, such as those in Section 50 of the Act, are limited to their specific, stated purposes—in this case, the computation of capital gains for depreciable assets. These fictions should not be extended beyond their intended scope to alter other tax implications, such as the applicable tax rates or the classification of assets for purposes unrelated to computation.*

This interpretation ensures that the legal fiction created by a statute does not override the broader characteristics and treatment of assets unless explicitly stated, thereby protecting taxpayers from unintended consequences.

- **Consistency in transfer pricing method to be maintained unless significant legal changes occur**

  - Principal Commissioner of Income Tax vs Sabic India Private Limited[4]

The taxpayer, Sabic India Private Limited ('SIPL'), a member of the Saudi Basic Industries Corporation ('SABIC') group, provides market support services to its Associated Enterprises ('AEs') but does not enter into any contract with customers or trade in the products supplied by its AEs. SIPL receives commission income for providing marketing support services. During FY 2015-16, SIPL used the Transactional Net Margin Method ('TNMM'), with Operating Profit/ Value Added Expenses ('OP/VAE') and Gross Profit/ Value Added Expenses ('GP/VAE') as its Profit Level Indicators ('PLIs'), to benchmark its international transactions.

The tax officer, however, rejected the taxpayer's comparables, reasoning that the selected companies were involved in trading activities. Further, the tax officer discarded the TNMM and applied the Other Method ('OM') as prescribed under Rule 10B of the Income Tax Rules, 1962 ('the Rules'). The tax officer made a transfer pricing adjustment in respect of the international transaction. On appeal, the Dispute Resolution Panel ('DRP') upheld the tax officer's approach.

The taxpayer filed an appeal before the Tribunal. The Tribunal noted that the tax officer's order lacked specific reasoning for rejecting the TNMM method. The Delhi Tribunal observed that any issues with the comparable companies used in the TNMM method should have been addressed individually, rather than rejecting the entire method.

The Delhi Tribunal relied on the Delhi High Court ('Delhi HC') decisions in Sumitomo Corporation India Private Limited vs Commissioner of Income Tax[5] and Li & Fung India Pvt. Ltd. vs Commissioner of Income Tax[6] to conclude that the TNMM with OP/VAE as the PLI, was the most appropriate method for benchmarking in the taxpayer's case.

Referring to ICAI guidelines, the Delhi Tribunal clarified that, before adopting the OM, the tax officer was required to substantiate the rejection of the five other prescribed methods under Rule 10B of the Rules.

The Revenue then challenged the Delhi Tribunal's order before the Delhi HC. While assessing facts, the Delhi HC observed that the taxpayer has consistently applied TNMM method from FY 2008-09 to FY 2013-14, indicating that the tax officer's deviation lacked adequate justification. The Delhi HC observed that, although the principle of res judicata does not strictly apply to tax assessments, consistency should be maintained unless there are significant statutory changes.

The Delhi HC reiterated that the OM should only be used when no other method is suitable due to a lack of comparable data or unique transactions. It also noted that the tax officer failed

[4] ITA 514/2024 & CM APPL. 59663/2024 (Delhi High Court)
[5] (2016) 387 ITR 611 (Delhi)
[6] (2014) 361 ITR 85 (Delhi)

to provide comparable uncontrolled transactions as required by Rule 10AB of the Rules. The Delhi HC further acknowledged the taxpayer's use of TNMM with OP/VAE and GP/VAE, showing a higher PLI than the comparables, with supporting benchmarking studies adjusted for stock and working capital.

Based on the above observations, the Delhi HC upheld the Delhi Tribunal's view, concluding that no substantial question of law arose in this appeal.

JMP Insights – *The above judgement has critical implications for transfer pricing in India, especially for companies using TNMM in similar low-risk, commission-based service models. It emphasises that a method consistently accepted over several years should not be discarded without proper justification, and comparables must accurately reflect the taxpayer's business model.*

- **Supreme Court rules on applicability of extended timelines to issue notices for reassessment under the new tax regime**

    - Union of India & Ors vs Rajeev Bansal[7]

The case refers to the validity of reassessment notices issued by the Income tax Department considering the amendments in the provisions of the Act from time to time.

The key events relating to reassessment proceedings are as follows:

- Old reassessment regime under the Act was applicable till 31 March 2021.
- Central Board of Direct Taxes ('CBDT') had introduced the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act ('TOLA'), thereby extending the time limit for compliance or completion of actions under the Act for reassessment notices falling between 20 March 2020 to 31 March 2021 (COVID-19 disruption period) .The time limit for issuance of notice under TOLA was further extended from 31 March 2021 to 30 June 2021.
- Subsequently, Finance Act 2021, with effect from 1 April 2021 introduced the new reassessment regime, wherein key reforms to sections dealing with reassessments procedure and time limits were made.
- 1st round of litigation before the SC on the validity of notices issued during the period 1 April to 30 June 2021 under the old reassessment regime (pursuant to extension of time limit under TOLA) despite the introduction of new reassessment regime with effect from 1 April 2021.
- On the aforesaid ground, SC in case of Ashish Agarwal invoked the powers under Article 142 of the Constitution of India and held that the impugned notices issued from 1 April to 30 June 2021 shall be deemed as Show Cause Notices ('SCN') under the new reassessment regime for conducting pre-notice inquiry.

[7] Civil Appeal No 8629 of 2024

- CBDT introduced instructions dated 11 May 2024 to implement the SCs direction in Ashish Agarwal's case.

The key issues before the SC in the case of Rajeev Bansal were as follows:

i. Whether TOLA continued to govern reassessment proceedings that were initiated after introduction of new reassessment regime from 1 April 2021?

ii. Whether notices issued under the new reassessment regime (as per direction of Supreme Court) between July 2022 and September 2022 are valid?

Ground No i

The SC made the following observations -

- TOLA has a non-obstante clause and overrides the provisions of the Act. It will apply to the provisions of the Act even post its amendment (after introduction of new regime) provided the proceedings relate to past assessment years.

- The new reassessment regime is remedial and substituted with a specific aim and object to protect the rights and interests of the taxpayer. The benefit of new regime shall be made available even to the proceedings relating to past assessment years, provided the reassessment notice has been issued on or after 1 April 2021.

- The notices must be issued under the substituted provisions of the new regime.

Ground No ii

In case of the reassessment notices issued between July and September 2022, the taxpayers appealed before various HCs on the validity of the new reassessment notices issued pursuant to SC decision in case of Ashish Agrawal. The taxpayers took a stand that for FYs ending 31 March 2013 and 31 March 2014, the time limit to issue the notices under the old regime has expired and therefore, the notices are time barred.

Further, notices for FYs ending 31 March 2016 and 31 March 2017 were issued without obtaining sanction from the appropriate authority.

The HCs declared the notices to be invalid against which the tax authorities appealed before the SC.

The SC made the following observations -

- The new regime was applicable from 1 April 2021 and applied to all notices issued thereafter. Further, TOLA extended statutory timelines for 'any' actions under the Act falling during Covid-19 disruption period, extended to 30 June 2021.

- In the case of Ashish Agrawal, the SC held the notices issued under the old regime as pre-inquiry notices under the new regime. Further, in the current ruling, the SC clarified on computation of the limitation period for determining the validity of the notices.

The SC observed the following:

- The period during which the proceedings are kept on hold are to be excluded from computing the limitation period. Accordingly, the period between the date of issue of deemed notices under the new regime and the date of order in case of Ashish Agrawal (4 May 2022) need to be excluded.

- Further, the time period of 30 days allowed to the tax officer for providing relevant information and material and additional two weeks given to taxpayers for submitting any response to the tax officer are to be excluded in computing the limitation period.

- The SC has explained the calculation of the surviving time limit i.e., the period within which the tax authorities are required to issue reassessment notice under new regime.

- Extension granted in limitation period due to applicability of TOLA will not change the class of sanctioning authority, as otherwise applicable to the taxpayer.

Based on the aforesaid observations, SC has upheld the validity of the notices issued under the new reassessment regime between July and September 2022.

JMP Insights – *The SC ruling has given lifeline to all 90,000 cases where the notices are issued under the old reassessment regime, by overturning various HC decisions which had taken contrary view.*

This judgement of the SC provides major relief to the Tax Authorities by reading TOLA into the amended provisions of the Act and upholding the validity of reassessment notices under the new regime issued between July and September 2022.

- **Taxpayer deemed Indian resident by virtue of tie-breaker rule under India USA DTAA**

  - Ashok Kumar Pandey vs. ACIT[8]

The taxpayer, an individual, is a resident of India and USA for the FY 2012-13. He has a permanent home available to him in India and USA. The taxpayer submitted that since he is a resident of India and USA, his residential status shall be determined upon his personal and economic relation and its closeness (centre of vital interest).

The taxpayer claimed that he is a US passport holder, having larger investments in USA and also his daughter is studying in USA, therefore, he is resident of USA as per the India USA Treaty. Accordingly, taxpayer contended that income earned in USA shall not be taxable in India.

The tax officer disregarded the claim of the taxpayer and proceeded to tax his global income in India holding the taxpayer's centre of vital interests in India on the following grounds:

i. Stay in India for more than 183 days during the year
ii. Active participation in managing affairs of Indian company
iii. Combined shareholding of taxpayer and his wife in Indian company is 100%

[8] ITA No. 3986/MUM/2023

iv. Investments in Mutual funds and shares in India
v. Income earned from USA is passive in nature. No active involvement required in income earned from USA

The Learned CIT(A) ruled in favour of the Revenue. On appeal, the Mumbai Tribunal has laid down the parameters to be considered for determining the place of personal relations and the economic interest of the taxpayer. After considering the personal relations and the nature of income earned by the taxpayer from India and USA, the Tribunal observed that the taxpayer stays in India with his wife, son and one daughter and the stay of the extended family including parents in USA is not so relevant in determining the personal interest of the taxpayer. Further, the nature of income earned in India requires active participation of the taxpayer. The income earned by the taxpayer from USA is passive in nature and does not require active involvement. Therefore, on a comprehensive appraisal, it is clear that the personal and economic relations of the taxpayer are more in favour of being close to India as compared to USA. Accordingly, the grounds raised by the taxpayer were dismissed and the Tribunal confirmed that his global income is chargeable to tax in India.

***JMP Insights** – When a person is a resident of both India and USA, the tie-breaker rule under Article 4 of the India USA DTAA is applied to determine the country of residence for tax purposes. The tie-breaker rule lays down a set of parameters to resolve dual residency situations.*

The aforesaid case provides a detailed application of the tie-breaker rule under the India USA DTAA, highlighting the importance of both personal and economic factors in determining the centre of vital interests. Active involvement in business activities, such as attending board meetings and making investments, is more determinative than passive investments.

The taxpayer bears the responsibility of proving that his centre of vital interest lies outside India. The determination of residency has significant tax implications, as it impacts the taxability of global income in India.

DID YOU KNOW?

- In the past, salaried employees were eligible for refund of any TDS (other than TDS on salary)/TCS only at the time of filing the Return of Income. With a view to address this issue, the Finance Act 2024 has allowed salaried employees to claim credit of any TDS or TCS during the FY while computing the TDS on salary.

- To give effect to the aforesaid amendment, the CBDT has prescribed new Form 12BAA for salaried employees. Vide this Form, the employee is required to provide details of income chargeable under any head of income other than Salaries, any TDS or TCS or loss incurred under the head 'Income from House Property' during the FY. The information provided in Form 12BAA will be considered by the employer for computing the TDS on salary for the 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.

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