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An e-newsletter from **Lakshmikumaran & Sridharan**, India

January 2021 / Issue–76

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January
2021

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Dividend payments to non-residents: DTAA relief on the horizon?

By **Tanmay Bhatnagar**

A major relief has been provided by the Tax Tribunal in its recent ruling in *Giesecke & Devrient*[1] on the rate of tax applicable on dividends paid by an Indian company to its overseas parent.

Giesecke & Devrient [India] Pvt Ltd.: A new Hope

The main issues before the Tribunal in this case was related to transfer pricing adjustments and disallowance of certain expenditure. The taxpayer, an Indian company, raised additional ground before the Tribunal on the applicability of Indo-Germany tax treaty ('DTAA') on dividends paid by the taxpayer to its German parent company. As per the taxpayer, the Revenue was wrong in not extending the benefit of the lower rates of tax provided under the DTAA in respect of dividends and subjecting the payment of dividend to the rate of 15% provided in Section 115-O of the Income-tax Act, 1961 ('Act').

While examining if Dividend Distribution Tax ('DDT') was a tax on the company distributing the dividend or on its shareholders, the Tribunal referred to the decision of High Court in *Godrej and Boyce Manufacturing*[2]. The Tribunal concluded that the High Court had held that DDT is a tax 'on the company' and not 'on the shareholder'. However, Tribunal was of the view that while the liability to pay the DDT is on the payer company, the additional income-tax under Section 115-O is a levy on 'income', the definition of which includes 'dividend'.

The Tribunal analysed the legislative history of Section 115-O of the Act and the Memorandum explaining the Finance Bill, 1997 and Finance Bill, 2003. As per the Tribunal, the said documents clearly established that the levy of DDT on the payer company was '*driven by administrative considerations rather than legal necessity and further emphasis on the fact that levy is for all intents and purposes, a charge on dividends*'. It was also noted by the Tribunal that the ultimate burden of the DDT fell on the shareholders and not the payer company.

The Tribunal also analysed the Memorandum explaining the Finance Bill, 2020, wherein the change in dividend taxation regime scheme was explained. The Memorandum stated that currently the incidence of tax is on the payer company and not on the recipient of the dividend as it normally should be; since dividend is income in the hands of the shareholders, the incidence of tax should also be on them. The Memorandum further states that the DDT regime is '*iniquitous and regressive*' since it levies a flat rate of tax on distributed profits across the board regardless of the rate at which the recipient of dividend is otherwise taxed.

The Tribunal concluded that the erstwhile DDT regime had been enacted merely for administrative ease and it was withdrawn since it was leading to taxation of income at a fixed rate. Thus, the Tribunal concluded that DDT is a tax on dividends received by the shareholders and

[1] *Giesecke & Devrient [India] Pvt Ltd*. v. *Addl. CIT* - [2020] 120 taxmann.com 338 (Delhi-Trib.)

[2] *Godrej and Boyce Manufacturing Company Limited* v. *Dy. CIT* - [2010] 194 Taxmann 203 (Bom.)

not on the distributed profits of the payer company.

The Tribunal finally referred to Sections 4 and 5 of the Act and observed that they were subject to Section 90. Section 90(2) of the Act lays down that for taxpayers to whom the provisions of DTAA are applicable, the said provisions wherever beneficial shall prevail over the provisions of the Act. Since Section 4 i.e. the charging provision of the Act is itself subject to Section 90 and the levy of additional income tax under Section 115-O is in turn covered by Section 4, Section 115-O is also subject to Section 90. Therefore, the Tribunal held that tax rates specified in DTAA in respect of dividend must prevail over DDT.

Godrej and Boyce Manufacturing: A spanner in the works?

Although the Tribunal examined the judgment of High Court in *Godrej and Boyce Manufacturing*, the Tribunal did not consider the impact of the subsequent judgment of Supreme Court[3] in the said matter. Therefore, it is only apposite to analyze the findings of the Tribunal in the light of the Supreme Court judgment. The main question before the Apex Court in that case was whether Section 14A of the Act was applicable to dividend income on which tax is payable under Section 115-O. There, the taxpayer had argued that Section 14A of the Act would not apply to the dividend income that has suffered tax in the hands of the distributing company because it cannot be strictly construed as exempt income.

The Apex Court rejected the arguments of the taxpayer. The Court held that a literal reading of Section 14A clearly showed that it would apply where the income is not includible in the total income of the taxpayer-shareholder. The Court also held that even if it were to be assumed that the additional income tax levied under Section 115-O of the Act is applicable on the dividend and not on the distributed profits of the paying company, Section 14A would still be applicable. This is because sub-sections (4) and (5) of Section 115-O clearly lay down that further benefit of the payment of DDT cannot be claimed either by the paying company or the recipient shareholder.

From the above, it can be inferred that the Apex Court agreed with the arguments of the Department that DDT is an additional income-tax on the distributed profits of the dividend distributing-company (and not a tax on dividends earned by the shareholder per se). However, the judgment of the Apex Court had not made a categoric finding in this regard.

Conclusion

Dividend to non-residents: The way forward

Following the decision of the ITAT in *Giesecke & Devrient [India] Pvt Ltd.*, the arguments which could be taken by assessees to avail the beneficial rates provided of DTAAs over the rate provided under Section 115-O of the Act stand bolstered.

Moreover, considering that the said issue was brought before the ITAT by way of additional grounds, taxpayers can explore claiming any excess tax paid on dividends in the past as refund wherever such possibilities exist. Taxpayers should also reevaluate their decision to settle any pending appeals under the Vivad Se Vishwas Act, 2020 in the light of this possibility.

However, the specter of the Supreme Court's observations in *Godrej and Boyce Manufacturing Company Limited* on whether the DDT is a tax on the company distributing the dividend or on the

[3] *Godrej and Boyce Manufacturing Company Limited v. Dy. CIT: [2017] 81 taxmann.com 111 (SC)*

shareholders still looms large over the arguments advanced by the taxpayer.

While there appears to be a beacon for taxpayers sailing in the choppy seas of the erstwhile DDT regime, they may still have to negotiate some turbulence before getting to the dry lands of DTAAs.

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Notifications and Circulars

Extension of time limits under Income-tax Act, 1961 and Vivad Se Vishwas Act, 2020

In view of the challenges being faced by the taxpayers due to the prevailing COVID–19 pandemic, the CBDT has *vide* its Notifications Nos. 92/2020 and 93/2020 further extended the due dates for the following statutory and regulatory compliances:

S. No.	Statutory/Regulatory Compliance	Previous due-date (after earlier extensions)	New due date
(1)	Filing of ITR u/s. 139(1) of the Act for AY 2020-21 for companies and assessees required to get their accounts audited	31 January 2021	15 February 2021
(2)	Filing of ITR u/s. 139(1) of the Act for AY 2020-21 for assessees required to furnish TP reports	31 January 2021	15 February 2021
(3)	Payment of self-assessment tax for assessees mentioned in (1) and (2) with self-assessment tax liability up to INR 1 lakh	31 January 2021	15 February 2021
(4)	Filing of ITR u/s. 139(1) of the Act for AY 2020-21 for assessees other than those mentioned in (1) and (2)	31 December 2021	10 January 2021
(5)	Payment of self-assessment tax for assessees mentioned in (4)	31 December 2021	10 January 2021
(6)	Furnishing audit reports and TP reports	31 December 2020	15 January 2021
(7)	Declaration under the VSV Act	31 December 2020	31 January 2021

S. No.	Statutory/Regulatory Compliance	Previous due-date (after earlier extensions)	New due date
(8)	Passing of orders under the VSV Act	30 January 2021	31 January 2021
(9)	Passing of orders or issuance of notices by authorities under the Act or the Benami Transactions (Prohibition) Act, 1988	30 March 2021	31 March 2021

Faceless Penalty Scheme 2021 introduced

After the introduction of faceless assessment and faceless appeal scheme, the CBDT has introduced Faceless Penalty Scheme, 2021. Under the new scheme, the review of penalty orders and all the penalty-related proceedings will be handled digitally. The taxpayer will not be required to appear before the income tax authority at National Faceless Penalty Centre, National Faceless Penalty Centre, Penalty Unit or Penalty Review Unit, in connection with any proceedings under the scheme. Notification No. 2/2021, dated 12 January issued for the purpose, also prescribes the procedure for the scheme. Further, Notification No. 3/2021, also of the same date, lays down exceptions, modifications and adaptations, subject to which the provisions of Sections 2, 120, 127, 129, 131, 133, 133C, 136 and Chapter XXI of the Income Tax Act shall apply to the procedure for imposing penalty in accordance with the said Scheme.

Ratio Decidendi

Legal services provided by Indian law firm taxable in Japan under Article 12 of India-Japan DTAA – Foreign tax credit allowed

The assessee was an Indian law firm and was assessed to tax in the status of a partnership firm. During the AY 2014-15, the assessee had earned income from legal services from its Japanese clients on which tax at the rate of 10% was withheld under Article 12 of India-Japan DTAA by treating the said services as Fees for Technical Services (‘**FTS**’). The assessee claimed foreign tax credit (‘**FTC**’) in respect of the said taxes. However, the Assessing Officer was of the view that the services rendered by the assessee were in the nature of Independent Personal Services (‘**IPS**’) as defined Article 14 of the tax treaty and in the absence of any fixed base or presence in Japan, income from said services was taxable ‘only in India’. Thus, the FTC was denied to the assessee. On appeal, the CIT(Appeals) confirmed the order. The assessee appealed before the Tribunal.

The question before the Appellate Tribunal was whether the income earned by the assessee from professional services provided to the Japanese clients could be taxed in Japan under Article 12 of the India-Japan DTAA.

The Tribunal observed that there are overlapping areas in the definition of FTS under Article 12 *vis-à-vis* definition of IPS under Article 14 of the DTAA. It was further observed that this overlap was recognised and sought to overcome *vide* the exclusionary clause to FTS as provided in Article 12(4) which sought to exclude payment to any individual for IPS from the ambit of the term FTS. The Tribunal held that though normally specific Articles of the DTAA are to be applied over the general Articles but the DTAA must be read as a whole and in harmony. Thus, it held that since exclusionary clause provided in Article 12(4) extends to payment in the nature of IPS to individuals, Article 14 relating to IPS should be interpreted to be applicable to individuals alone. Observing that the assessee was a firm, it was held that the assessee was not eligible to claim benefit of Article 14 and the income of the assessee would be taxable under Article 12. The foreign tax credit was hence held available.

The Tribunal also held that in order to determine the foreign tax credit available to a resident, a judicious view should be taken. It was held that tax credit should be granted when the view adopted by source jurisdiction is *bonafide* even when such view does not represent the same legal position in the resident state. It was further held the view as taken by the treaty partner is to be adopted unless the interpretation given by the treaty partner is wholly unreasonable or manifestly erroneous. [*Amarchand & Mangaldas & Suresh A Shroff & Co* v. *ACIT* - I.T.A No.2613/Mum/2019 – Order dated 18 December 2020, ITAT Mumbai]

Gift of shares held as stock in trade when not taxable as business income

The assessee was a company engaged in the business of financing of goods, material, movable and immovable properties and is also trading in shares, securities, stocks and debentures. During the scrutiny proceedings, it was noticed that the assessee had gifted shares of certain companies of OP Jindal Group held as stock in trade to 4 different companies. The board resolution read along with explanatory statement stated that the equity shares held by the assessee were proposed to be transferred to other companies as part of the internal family realignment of the OP Jindal group. It was noted that the donee companies were incorporated few days before gifting of the shares and that the assessee had not credited the sales proceeds to the profit and loss account from the transfer of the shares which were held as stock in trade to various companies. The Assessing Officer noted that the shares were transferred to newly formed companies as a sequel to family realignment and such transfer was therefore not 'voluntary' in nature and accordingly could not be considered as a valid gift. The Assessing Officer thereby computed the total income of the assessee by making addition on account of transfer of the shares. On appeal, the CIT(Appeals) upheld the order of the AO. Aggrieved by the said order, the assessee appealed before the Tribunal.

The Tribunal observed that a family arrangement is an arrangement between members of the same family intended to be generally for the benefit of the family. Observing that a company being a separate and distinct entity does not form part of a family, it was held that the gift made by the assessee company cannot be said to be a part of a family arrangement. However, it was also observed that all the essential elements to constitute a valid gift *viz.* (1) absence of consideration, (2) the existence of donor, (3) the existence of donee, (4) voluntariness of the parties, (5) the subject matter, (6) the transfer, (7) the acceptance as provided in Section 122 of the Transfer of Property Act, 1882, were satisfied in the instant case. The Tribunal noted that there was no inflow of cash, receivables or other consideration and there was no accrual of any revenue to the assessee. Therefore, the order of the Assessing Officer that the books of the assessee being un-reliable, was reversed. Accordingly, the Tribunal allowed the appeal and held that no business income can be charged to tax in the hands of the assessee. [*Manjula Finance Ltd.* v. *ITO* - I.T.A. No.3727/Del/2018 – Order dated 18 December 2020, ITAT Delhi]

Interest on sum borrowed to repay loan utilised for construction of commercial property deductible under Section 24(b)

The assessee was a company engaged in the business of construction, development of real estate projects and renting of commercial building. The assessee filed its return of income for the relevant AY and for the purpose of computing income under the head 'Income from House Property' claimed deduction under Section 24(b) of the Act as interest paid on capital borrowed for the purpose of construction of the property. The assessee had borrowed money from Corporation Bank for the purpose of construction and letting out of commercial building. Subsequently, the assessee further borrowed money from another lender for repaying the loan taken from Corporation Bank. The Assessing Officer disallowed the entire claim of deduction on account of interest under Section 24(b) of the Act on the ground that third proviso read with second explanation to Section 24(b) of the Act is relevant only in relation to self-occupied property which is not the case of the assessee. On appeal, the CIT(A) allowed the claim of the assessee for deduction of interest paid to Corporation Bank but did not allow the claim of the assessee for deduction on account of interest paid to the subsequent lender. The CIT(A) rejected the reliance placed by the assessee on Circular No 28 dated 20 August 1969 on the ground that provisions of Section 24 of the Act had subsequently been amended w.e.f 1 April 2002. The assessee therefore, appealed before the Tribunal.

The CBDT *vide* Circular No. 28 dated 20 August 1969 had clarified that when a loan is taken to repay loan taken for construction of a property, interest paid on such loan is also deductible in computing under the head income from house property. The Tribunal observed that the amended provisions of Section 24 of the Act do not alter the scheme of determination of house property income with regard to allowability as deduction of interest paid on loans borrowed for the purpose of constructing the property. Therefore, the reason given by the CIT(A) for not allowing the claim of the Assessee was held to be unsustainable.

The ITAT Bangalore observed that Section 24(b) of the Act uses the expression 'property' and not residential or commercial property. Therefore, irrespective of the nature of the property, whether residential or commercial, deduction must be allowed under Section 24(b). It was held that the proviso only carves out an exception to Section 24(b), in so far as it relates to property used for residential purposes. The Proviso does not deal with or curtail the right of an assessee to get deduction on interest paid on loans borrowed for the purpose of constructing commercial property. On the said grounds, the deduction claimed by the assessee was allowed. [*Indraprastha Shelters Pvt. Ltd.* v. *DCIT* – ITA No. 2597/Bang/2019 – Order dated 18 December 2020, ITAT Bangalore]

Shares received in lieu of shares issued at premium is not unexplained cash credit under Section 68

The taxpayer-company had issued its shares at a premium to certain other companies in exchange of the shares held by the said companies. There was no inflow of cash in the transaction in question. The transaction was entered into in the books of taxpayer by way of journal entries but did not involve any credit to the cash account. No adverse finding or addition was made by the AO neither during the original nor the reassessment proceedings and the explanation provided by the taxpayer was accepted. However, subsequently, the CIT set aside the earlier assessments and ordered fresh enquiries *vide* order under Section 263 of the IT Act. Consequent to this, on account of the transaction in question, the AO made an addition under Section 68 of the Act on the ground that the directors of the share applicant companies did not appear before it.

In appeal, the ITAT Kolkata relied on the Calcutta High Court's decision in *Jatia Investment Co.* [206 ITR 718]. In the said High Court judgment, it was held that where there was no transfer of cash at any stage of a transaction nor did any of the parties pay or receive cash in the cash book, no addition can be made under Section 68 on account of unexplained cash credit. The ITAT held that the said ruling was squarely applicable to the present set of facts. It observed that there was no cash or credit involved in the whole transaction, rather it was simply a case of passing entries in books of accounts. Thus, it held that the question of cash credit does not arise and the addition under Section 68 was incorrect. [*ITO* v. *Josan Deposits and Advances Pvt. Ltd.* – I.T.A. No. 2096/Kol/2017 – Order dated 3 December 2020, ITAT Kolkata]

Shareholding of minor son cannot be combined with that of taxpayer-father while determining threshold under Sections 2(22)(e) and 2(32)

The taxpayer held 2.47% and 10% of the shareholding in companies A and B respectively. The minor son of the taxpayer also held 12% and 18% of shareholding in the said companies respectively. Company A had given intercorporate deposits of Rs. 13.97 crore to company B. The AO was of the view that the cumulative shareholding of the taxpayer in his individual capacity and in his capacity as the guardian of his minor son exceeded the thresholds provided in Section 2(22)(e) read with Section 2(32) of the Act. It held that the inter-corporate deposits were in the nature of dividend to the taxpayer and made an addition to the income of the tax payer.

In appeal, the CIT(A) deleted the addition by holding that the shareholding of the taxpayer could not be combined with the shareholding of his minor son. Thus, the threshold provided for in Sections 2(22)(e) and 2(32) were not exceeded. Further, the CIT(A) noted that the source of the shares held by the minor son was independent and that he alone was entitled to the beneficial ownership of the shares and that the taxpayer could not be held to be the beneficial owner of the said shares. To arrive at the said conclusion, the CIT(A) relied *inter alia* on the judgment in *ITO* v. *S.S.Barodawala* wherein the Bombay High Court held that simply because a father manages the affairs relating to the shares standing in the name of his minor sons as a guardian, he does not become the beneficial owner of the shares. On appeal, the ITAT Surat upheld the CIT(A)'s Order. [*ACIT* v. *Kamalbhai Jayantilal Shah* – IT(SS)A Nos. 261 & 262/AHD/2016 – Order dated 17 December 2020, ITAT Surat]

Private discretionary trust receiving voluntary contribution liable under Section 56(2)(vii) in its capacity as representative assessee on behalf of individual beneficiaries

The taxpayer is a discretionary trust created for the benefit of members and senior leaders of the Shriram Group. The tax payer received a voluntary contribution of INR 25 crores from some of the group entities which were shown in its books as a 'corpus donation'. Basis the directions issued by the Joint-Commissioner under Section 144A of the Act, the AO made an addition of the entire amount of voluntary contribution under Section 56(2)(vii). The CIT(A) upheld the assessment order, but the ITAT reversed the order of CIT(A) and granted relief to the taxpayer trust.

On appeal, the High Court of Madras upheld the addition made under Section 56(2)(vii) of the Act. The High Court noted that as per Section 161(1) of the Act, the tax payer would be assessed in the manner as its beneficiaries. Observing that neither the trustees nor the beneficiaries of the taxpayer-trust had come together with a common purpose, the Court rejected the contention of the taxpayer that it is to be assessed as an Association of Persons ('AOP'). It was held that the conditions for the constitution of an AOP laid down in the decision of the Supreme Court in *Indira Balakrisha* [39 ITR 546] were not satisfied.

The High Court noted that the beneficiaries of the trust were determinate since the method of determining which of the retired employees of the Sriram group was provided in the Trust Deed. The High Court held that the taxpayer was to be assessed as an individual since it was merely a representative assessee as per Section 160. It received income on behalf of and for the benefit of the beneficiaries, who in substance and form were the real owners.

Taxpayer's argument that the term 'individual' as used in Section 56(2)(vii) refers only to living persons and not artificial persons, as evident from a perusal of the third proviso to Section 56(2)(vii) was also rejected. The said proviso laid down that the provisions of the Section 56(2)(vii) would not apply with respect to any sum of money or property received from relatives, on the occasion of marriage or through inheritance. It noted that a proviso only acts as an optional addendum to the enacting provision. Observing that the sums were received by the representative assessee from neither the relatives of the beneficiaries nor on account of marriage, the additions made under section 56(2)(vii) of the IT Act were upheld by ITAT. [*CIT* v. *Sriram Ownership Trust* – T.C.A. No. 242 of 2018 – Order dated 8 December 2020, Madras High Court]

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