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DIRECT TAX UPDATE

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SUMMARY OF JUDGEMENTS

1) Transfer Prising and International Taxation Case Laws:

a) CIT Vs. M/s Grup ISM P. Ltd. (ITA No 325 of 2014-Delhi High Court)

Agency service provided by the foreign entity cannot be considered as consultancy or technical service and no TDS is to be deducted on the same.

b) Director of Income Tax Vs. M/s. B4U International Holdings Limited (ITA No. 1274 of 2013-Bombay High Court)

Indian agent of foreign company cannot be regarded as "Dependent Agent Permanent Establishment" if agent has no power to conclude contracts.

2) Domestic Case Laws:

a) CIT Vs. M .M Aqua Technologies Ltd. (ITA 110 of 2005-Delhi High Court)

Conversion of outstanding interest into a loan does not amount to an "actual payment" of the interest and so deduction for the interest cannot be claimed.

b) M/s Chennai Properties & Investments Ltd Vs. CIT (Civil Appeal No 4494 of 2004-Supreme Court)

Where the main object of assessee-company was to acquire properties and earn income by letting out same, the said income was to be brought to tax as 'income from business and profession' and not as 'income from house property'

c) ITO Vs. Earnest Towers (P) Ltd (ITA No. 265/Kol/2012-Kolkata Tribunal)

Section 94-I of the Act applies only to amounts paid for "use" of the land and not for amounts paid to "acquire" the rights. There is a distinction between "lease premium" and "rent" and cannot be used alternatively.

d) ITO Vs. Shri Paresh Arvind Gandhi (ITA No. 5706/Mum/2013-Mumbai Tribunal)

The inclusion of individuals in the "Hawala" list doesn't imply that all transactions entered into with them are bogus.

e) Natural Gas Company Private Limited. Vs. DCIT (ITA No.47/Mum/2011-Mumbai Tribunal)

Interest paid on money borrowed to acquire shares cannot be treated as an expense for cost of acquisition of shares.

3) <u>Circulars:</u>

a) Circular on condonation of delay in filing refund claim and claim of carry forward of losses.

b) Extension of due date of filing return of income in respect of non-corporate assessee for Assessment Year 2015-16.

1) <u>Transfer Prising and International Taxation Case Laws:</u>

a) CITVs. M/s Grup ISM P. Ltd. (ITA No 325 of 2014-Delhi High Court)

Agency service provided by the foreign entity cannot be considered as consultancy or technical service and no TDS is to be deducted on the same.

Facts of the case:

The assessee had made payment of Rs 56,54,963/- to M/s. CGS International, UAE and Rs37,76,863/- to M/s. Marble Arts & Crafts LLC, UAE. The AO noted that no TDS had been deducted by the assessee while making the payment to the said two foreign concerns. The assessee contended that the payments were made towards commission and that neither of these concerns had any business in India nor had they filed any Income Tax Return in India. The assessee further referred to Article 14 of Double Taxation Avoidance Agreement (DTAA) and contended that in view of such stipulation it was not required to deduct TDS.

The A.O rejected the assessee's contention and disallowed the expenditure under section 40 (a)(i) of the Act.

On an appeal before Commissioner of Income tax (Appeals), it was held in favour of assesse not considering the payment made within the purview of 'technical services' and further added applicability of Article 14 of DTAA with UAE.

ITAT also held in favour of assessee, dismissing revenue's appeal and affirmed CIT(A)'s order.

Revenue filed an appeal before the High Court.

Decision of the Hon'ble High Court:

Perusing various facts of the case, nature of business and transaction undergone by the assessee, it was concluded by the Hon'ble High Court that the services provided to the assessee would not be considered as consultancy services as the UAE entities acted as an agent for the assessee. The remittances made by the assessee would not come within the scope of the phrase "fees for technical services" as employed in Section 9(1)(vii) of the Act and further also justified applicability of Article 14 of DTAA with UAE. The Hon'ble High Court dismissed revenue's appeal.

Therefore, agency service provided by the foreign entity does not come in the ambit of consultancy service or fees for technical services and no TDS is required to be deducted on the same.

b) Director of Income Tax Vs. M/s. B4U International Holdings Limited (ITA No. 1274 of 2013-Bombay High Court)

Indian agent of foreign company cannot be regarded as "Dependent Agent Permanent Establishment" if agent has no power to conclude contracts.

Facts of the case:

The assessee is a Mauritius based company. It is engaged in business of telecasting of TV channels such as B4U Music, MCM etc. The assessee claimed that it did not have any permanent establishment in India and thus, no tax liability.

The revenue claimed that income of the assessee from India consisted of collections from time slots given to advertisers from India through its agents thus constituting a Dependent Agent Permanent Establishment in India.

The assessee appealed before the CIT(A), wherein it was decided in favour of assessee. Aggrieved by the order of CIT(A), revenue preferred an appeals to the ITAT. Hon'ble Tribunal also upheld the order of CIT(A). Revenue filed an appeal before the High Court.

Decision of the Hon'ble High Court:

The Hon'ble High Court while deciding in favour of assessee held as under:

- The assessee carries out the entire activities from Mauritius and all the contracts were concluded in Mauritius. As per the agreement between the assessee and B4U, B4U India is not a decision maker nor does it have the authority to conclude contracts. Further, barring the agreement, the

Revenue has not brought anything on record to prove that agent has such powers.

- The only activity which is carried out in India is incidental or auxiliary / preparatory in nature which is carried out in a routine manner as per the direction of the principal without application of mind.
- Nearly 4.69% of the total income of B4U India is commission / service income received from the assessee company and, therefore, also it cannot be termed as dependent agent.

Thus, when the activities of a person are not devoted exclusively or almost exclusively on behalf of that enterprise or; where such persons are acting in the ordinary course of their business. He will not be considered an agent of dependent status.

2) <u>Domestic Case Laws:</u>

a) CIT Vs. M .M Aqua Technologies Ltd. (ITA 110 of 2005- Delhi High Court)

Conversion of outstanding interest into a loan does not amount to an "actual payment" of the interest and so deduction for the interest cannot be claimed.

Facts of the Case:

The assessee was heavily indebted to its institutional creditor with ICICI as a lead manager of those creditors. The accumulated interest on the overdue principal had mounted to Rs 30,014,900. The assessee was unable to discharge this interest liability due to its financial hardship. The ICICI waived a part of the compound interest together with the commitment charges and agreed to accept 300,149 convertible debentures of 100 each, amounting to 30,014,900 in lieu of the outstanding interest.

The assesse had claimed its interest deductible in its return, explaining that it was actually paid by it in the relevant accounting period.

The assessee's stand (of having actually paid, by issuing the debentures) was rejected by the Assessing Officer (AO) on the premise that the debenture issue resulted only in postponement of the interest liability and that the interest could not be considered as having been "actually paid" as required by Section 43B of the Act to qualify for relief.

On appeal before CIT(A), it urged that the issue of debentures is equivalent to the amount of outstanding interest amounted to actual payment of the interest liability and, therefore, it has to be allowed as a deduction. The CIT(A) accepted the assessee's contentions and directed the AO to allow the deduction as claimed. The Hon'ble ITAT also held in favour of assessee.

Assailing the said order passed by the Hon'ble ITAT, the revenue filed an appeal before the High Court.

Decision of Hon'ble High Court:

Relying upon various case laws, the Hon'ble High Court held that Explanation 3C and 3D of section 43B of the Act were introduced by the Finance Act, 2006, with retrospective effect from 01.04.1989 and 01.04.1997 respectively. Thus, these two explanations were not present at the time the impugned order was passed. But, as it have retrospective effect, it is applicable to the present case as it relates to A.Y 1996-1997.

For application of Explanation 3C and 3D, the loan has to be taken from any public financial institution. As the loan was taken from

ICICI bank, the interest on loan taken by the assessee from it would fall within the purview of Section 43B(d) of the Act.

Thus, it negates the assessee's contention that interest which has been converted into a loan is deemed to be "actually paid".

Thus, no deduction can be claimed of interest on loan, if the outstanding interest is converted into loan, as it does not amount to actual payment.

b) M/s Chennai Properties & Investments Ltd Vs. CIT (Civil Appeal No 4494 of 2004-Supreme Court)

Where main object of assessee-company was to acquire properties and earn income by letting out same, said income was to be brought to tax as business income and not as income from house property

Facts of the case:

The assessee is a company with its main objective to acquire the properties and to let out those properties. The assessee had rented out such properties and the rental income received therefrom was shown as income from business. The Assessing Officer, however, rejected the same and treated it as income from house property.

On appeal before CIT(A), it was held that the income should be taxed as income from business and not as income from house property.

Aggrieved by the decision, the revenue filed an appeal before the Hon'ble ITAT, who declined to interfere with the order of the CIT(A) and dismissed the revenue's appeal.

Aggrieved by the order of the Hon'ble ITAT, revenue filed an appeal before the Hon'ble High Court, where it contended that income derived by letting out of the properties would not be income from business but could be assessed only income from house property. The Hon'ble High Court accepted the argument of revenue and restored the AO order.

Decision of Hon'ble Supreme Court:

The Memorandum of Association of the assessee-company mentions that main object of the company is to acquire and hold the properties and to let out those properties as well as make advances upon the security of lands and buildings or other properties or any interest therein. It may further be noted that in the return that was filed, entire income which accrued and was assessed in the said return was from letting out of these properties. It is so recorded and accepted by the assessing officer himself in his order.

In aforesaid circumstances, it is concluded that letting of the properties is in fact is the business of the assessee. The assessee therefore, rightly disclosed the income under the head income from business. It cannot be treated as 'income from the house property'.

Therefore, income from letting of properties is assessable as "business profits" and not as "Income from house property" if it is the business of the assessee.

c) ITO Vs. Earnest Towers (P) Ltd (ITA No. 265/Kol/2012-Kolkata Tribunal)

Section 94-I of the Act applies only to amounts paid for "use" of the land and not for amounts paid to "acquire" the rights. There is a distinction between "lease premium" and "rent" and cannot be used alternatively.

Facts of the case:

The assessee is a private limited company and is engaged in the business of real estate investment. MMRDA allotted a plot of land measuring 8076.38 sq.mts to the assessee on lease for a period of 80 years. As per the lease deed, the assessee was also required to pay the annual rent every month of Rs. 8077 every year to MMRDA. The contention of the Revenue was that the assessee did not deduct TDS on the aforesaid amount of Rs. 1041.42 crores paid to MMDA.

The assessee was therefore treated as assessee in default in terms of section 201(1) and 201(1A) of the Act for non- deduction of TDS and non- payment of interest amounting to Rs. 325,65,95,400/- On appeal by the assessee, CIT(A) held in favour of assessee, distinguishing between lease premium and rent and came to the conclusion that premium is not paid under lease but is paid as a price for obtaining the lease.

Decision of the Tribunal:

The Hon'ble Tribunal held as under:

- If the payment made was for use of land then assessee was required to deduct tax u/s 194 I of the Act, otherwise not. But the assessee used the rights for exploiting the property by constructing commercial apartments rather than using the property.
- As per the Lease Deed, the assessee is further permitted to sell and mortgage, assign, underlet or sublet or part with the

possession of the premises or any part of there or any interest therein the demised with the consent of Metropolitan Commissioner and after making payment of transfer charges. This leaves no doubt that the lease premium was for acquisition of rights in the lease hold property rather than use of land.

- Further, the amount paid by the assessee for lease premium has no connection with the market rent of the property leased to the assessee and the lease was for considerable period of 80 years. Reliance is also on following cases
- o CIT vs Panbari Tea company Ltd (57 ITR 422) (SC);
- o CIT vs Purnendu Mullick (116 ITR 0591); and
- o ITO (TDS) vs Navi Mumbai SEZ Pvt. Ltd. (147 ITD 0261) (Mum)

Thus, the issue is decided in favour of the assessee, dismissing the appeal.

Therefore TDS on rent is deducted only when there is use of land and not when assessee uses the right to exploit the property.

d) ITO Vs. Shri Paresh Arvind Gandhi (ITA No. 5706/Mum/2013-Mumbai Tribunal)

The inclusion of individuals in the "Hawala" list doesn't imply that all transactions entered into with them are bogus.

Facts of the case:

The assesssee is the proprietor of a business that is engaged in the installation, erection and servicing of water purifying systems. He declared total income of Rs. 18.40 lacs. However the AO determined income at Rs.15,605,880/-. During the assessment, the AO found that there were 7 suppliers who appeared in the list of "Suspicious Dealers" (indulged in issuing only bills without delivery

of any goods for a commission) as per sales tax department records, thus declaring the associated purchases as unexplained expenditure.

The assessee argued that purchases made by him were genuine and purchase of material was duly recorded in the books of accounts. Further, material purchased during the year was used in production of equipment's.

The AO argued that purchases made by the assessee, per se, were not treated as bogus but the expenditure incurred on such purchases was to be treated as unexplained. The assessee was unable to give any convincing explanation as to how those goods happened to come in his possession. The 7 parties referred above were engaged in issuing bills only.

Thus, the AO made an addition of Rs. 1.37 crores to the total income of the assessee under the head unexplained expenditure, as per the provisions of sec. 69C of the Act. Aggrieved by the order of the AO, the assessee preferred an appeal before the CIT(A). The CIT(A) held in favour of the assessee and deleted the addition. Revenue filed an appeal before the Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal while giving relief to assessee held as under:

- The payments were made through banking channels. The AO had not doubted the genuineness of the purchase but had made the disallowance of Rs.1.37 crores invoking the provisions of Sec. 69C of the Act.

- Placing reliance on the decision in case of**DCIT Vs. Shri Rajeev G. Kalathil (ITA No. 6727/Mum/2012)**,the Hon'ble Tribunal following the principles laid down in the said decision, deleted the addition made by the AO**.**

The "Hawala" list cannot be the conclusive evidence that transactions entered into with such individuals will be bogus and that Sec 69C of the Act will be attracted.

e) Natural Gas Company Private Limited. Vs. DCIT (ITA No.47/Mum/2011-Mumbai Tribunal)

Interest paid on money borrowed to acquire shares cannot be treated as an expense for cost of acquisition of shares.

Facts of the case:

The assesse had acquired shares in FY 1997-98 and had borrowed capital for such investment. The said shares, acquired by the assessee during the FY 1997-98 (or even prior thereto) up to 1992-93, were sold during the relevant previous year, yielding capital gains. The assessee claimed the interest cost from FY 1997-98 onwards up to the current year - the year of transfer, indexing it for the inflation as obtaining from year to year, as part of the cost of acquisition and/or improvement.

The Assessing officer (AO) disallowed the same stating that interest cost relating to borrowings made to finance the acquisition of a capital asset, could not be considered as toward its acquisition as the acquisition is already complete upon passing of property to the owner.

On appeal, CIT(A) upheld the order of AO.

Aggrieved by the order of CIT(A), assessee preferred an appeals to the Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal while deciding in favour of revenue held as under:

- Acquisition of asset is complete on transfer of the relevant capital asset to the assessee. The interest cost for the post acquisition period, as would be apparent from the foregoing, does not in any manner contribute towards the same.

- The Hon'ble Tribunal relying upon decision of **Hon'ble Supreme Court in case of India Cements Ltd. vs. CIT [1966] 60 ITR 52 (SC),** held that a loan cannot itself be treated as an asset or an advantage for the enduring benefit for the business of the assessee. Similar view was taken in **CIT vs. Tata Iron & Steel Co. Ltd. [1998] 231 ITR 285 (SC).**

Thus, financial obligations attached to an asset would not have a bearing on its cost of acquisition. Hence, the same cannot be treated as a cost of acquisition of an asset.

3) <u>Circulars:</u>

a) Circular on Condonation of Delay in filing refund claim and claim of carry forward of losses.

The Central Board of Direct Taxes (CBDT) has issued Circular No. 9/2015 dated 9th June 2015 to deal with the issue of condonation of delay in filing refund claim and claim of carry forward of losses under section 119(2)(b) of the Income-tax Act. The said Circular contains comprehensive guidelines on the conditions for condonation and the procedure to be followed for deciding such matters.

This circular will cover all such applications/claims for condonation of delay under section 119(2)(b) of the Act which are pending as on the date of issue of the Circular.

b) Extension of due date of filing return of income for Assessment Year 2015-16.

The CBDT has extended the 'due date' for filling Returns of Income for Assessment Year 2015-16 from 31st July, 2015 to 31st August, 2015 in respect of the non-corporate assessees who are not required to gets its accounts audited under Income Tax Act or under any other law for the time being in force.