Lakshmikumaran & Sridharan attorneys

Direct Tax

amicus

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

May 2021 / Issue–80

Contents

Article
Redesigned taxation upon exit from partnership firm – New jeopardy for taxpayers? 2

Notifications & Circulars 5

Ratio Decidendi 9

May
2021

Article

Redesigned taxation upon exit from partnership firm – New jeopardy for taxpayers?

By **Harshit Khurana and Devashish Jain**

Introduction

Taxation upon exit of a partner from a partnership firm has been a contentious issue since long. Till Financial Year 1987-88, distribution of capital assets on dissolution of partnership firm was specifically excluded from capital gain taxation[1]. Resultantly, as a tax planning exercise, taxpayers used to convert partnership assets into individual assets either upon retirement or dissolution, contending that no capital gains tax was payable in relation to the same.

To prevent misuse of exemption provisions, the Legislature introduced Section 45(4) in the Income-tax Act, 1961 ('**IT Act**') *vide* Finance Act, 1987[2]. This new provision imposed capital gains tax in the hands of the partnership firm if the firm distributes capital asset(s) to its partners either upon dissolution or otherwise. Though the said provision was intended to plug the loopholes in the earlier regime (i.e. pre-1988), however, it ended up resulting in long-drawn litigation between taxpayers and the Department on numerous issues.

Introduction of amendment to resolve these issues under Section 45(4) was thus certainly one of the things on the taxpayers' wish list. However, through Finance Act, 2021, the Legislature has gone far beyond the expectations of the taxpayers by redesigning the entire scheme of taxation upon reconstitution and dissolution of partnerships.

Redesigned law: Favourable to the taxpayer or the taxman?

This Article critically analyses the above question and also analyses some of the open issues that are present in the newly enacted provisions. The amendments proposed by the Legislature are discussed in subsequent paragraphs.

Substitution of Section 45(4) of the IT Act

The amended provision starts with a non-obstante clause and hence, will override anything contrary provided in the IT Act. The section provides as follows:

- Where a **specified person (i.e. partner or member)** receives money or capital asset(s) or both from a **specified entity (i.e. firm or AOP or BOI)** in connection with the reconstitution of the specified entity,
- then any profit or gains arising from receipt of such money by the specified person shall be chargeable to income-tax as income of such specified entity under the head 'Capital gains.
- Gains arising under Section 45(4) shall be computed as per the following formula:

Formula: A = B + C – D
A = Capital Gain chargeable to income-tax* **B** = Money received

[1] Not considered as transfer as per Section 47(ii) of the IT Act.
[2] Para 36 to Memorandum explaining the Provisions in the Finance Bill, 1987.

© 2021 Lakshmikumaran & Sridharan, India
All rights reserved

Formula: A = B + C – D
C = FMV of Capital asset(s) received **D** = Capital Account balance of partner or member (without taking into account increase in capital account due to revaluation of any asset or due to self-generated goodwill or other self-generated asset) *In case '**A**' in the above-mentioned formula comes out to be negative then it shall be deemed to be zero.

The term 'reconstitution of specified entity' as used in the aforesaid provisions has been defined to mean –

- Retirement of one or more partner or member;
- Admission of one or more partner or member in a firm/AOP/BOI wherein at least one existing partner or member continues;
- Change in the share of some or all the partners or members.

Analysis of above provision

The above provision taxes the gains derived by a partner upon receipt of money or capital asset or both at the time of reconstitution of the firm. The gains derived by the partner have been deemed to be the income of the firm and accordingly taxed in the hands of firm. The provision will operate mostly in cases of retirement when a partner receives money for its share in the firm.

The way the provision has been worded, it seeks to resolve the litigation around following prevalent issues in past:

- Taxation on receipt of money (or any other asset) by partner upon retirement has been a contentious issue with judgments existing in both favour and against. With the amendment, the Legislature seems to favour the view that upon retirement of a partner, there is transfer of right in the partnership firm and hence, capital gains tax should be levied in respect of the same.
- The provision explicitly clarifies that the amount of revaluation of assets is not to be included in the capital account balance of the partner while computing capital gains, resulting in additional tax cost for the retiring partners.

In the past, various Benches of Tribunal have decided this issue in favour of taxpayers by holding that revaluation amount is to be included in the capital account balance for computing capital gains. However, this amendment overrides the ratio laid down in those decisions.

Introduction of Section 9B to the IT Act

As discussed, the Finance Act, 2021 has also introduced a new provision i.e. Section 9B in the IT Act. Provisions of Section 9B provides as under:

- Where a **specified person (i.e. partner or member)** receives during the previous year capital asset or stock-in-trade or both from a **specified entity (i.e. firm or AOP or BOI)** in connection with dissolution or reconstitution of such specified entity,
- then the specified entity shall be deemed to have transferred such capital asset or stock-in-trade or both, as the case may be, to the specified person in the year in which such assets are received by the specified person.
- Profit or gains arising from receipt of such deemed transfer shall be chargeable to income-tax as income of such specified entity under the head 'PGBP' (in case of stock-in-trade) or 'Capital gains'.

© 2021 Lakshmikumaran & Sridharan, India
All rights reserved

- The fair market value of the capital asset or stock-in-trade shall be deemed to be the full value of consideration for computation of capital gain.

Analysis of above provision

The newly enacted provision seeks to tax the transfer of capital assets or stock-in-trade by a firm to its partner upon dissolution or reconstitution. The provision resolves the following issues litigated in the past:

- In the earlier regime, taxation upon transfer of capital assets at the time of retirement was a contentious issue. There were judgments both in favour and against of taxing said gains. The new provision has now expressly provides that capital gains tax will apply in case a capital asset is transferred to the partner.

Earlier if stock-in-trade was distributed to the partner, partnership firms used to argue that no tax was payable by the firm under the erstwhile Section 45(4). However, the new provision has made it amply clear by providing that the same will be taxed under the head 'PGBP'.

The above amendments also tilt the bar in favour of the taxman.

Amendment to Section 48(iii) of the IT Act

To understand the amendment made by Section 48(iii), it is important to understand the interplay between Sections 45(4) and 9B of the IT Act. Let us understand the same with the help of an illustration:

- FMV of Capital Asset received by the partner upon retirement– INR 1,000/-
- Cost of Capital Asset – INR 200/-
- Capital Account balance of partner (without revaluation) – INR 700/-

In the above facts, taxation under the new provisions is as follows:

- Capital gains under Section 45(4) - 1000 (FMV of capital asset) *less* 700 (capital account balance) = 300
- Capital gains under Section 9B ***(without reading amendment to Section 48)*** - 1000 (FMV of capital asset) *less* 200 (cost of asset) = 800
- Impact of amendment to Section 48 - The double taxation of INR 300 as evident in Section 45(4) and Section 9B has been sought to be eliminated.

With the amendment to Section 48(iii), while computing the full value of consideration under Section 9B, the capital gains attributable to the capital asset which has got subjected to tax in Section 45(4) will be excluded. Meaning thereby, the full value of consideration in the above example will be considered as Rs. 700 (i.e. 1000 *less* 300) instead of Rs. 1000.

Issues in the newly introduced provisions

While the new provisions have attempted to resolve the litigation around certain issues, the way the provisions have been worded, they may open litigation in few new issues. Some of the potential issues are discussed as follows:

- ***Taxation under Section 45(4) on receipt of asset other than capital asset -*** Section 45(4) becomes applicable when a partner receives money or capital asset from the partnership firm. In case a partner receives stock in trade, on literal reading of provisions one would want to contest that Section 45(4) will be inapplicable. However, the Taxman may argue that under Section 45(4), the term 'capital asset' should be read *qua* the partner

© 2021 Lakshmikumaran & Sridharan, India
All rights reserved

and not *qua* the partnership firm and hence, even receipt of stock in trade will be taxable in Section 45(4).

- ***Capital gains under Section 45(4) will qualify as short term or long-term capital gains?*** – Classification of capital gains into long term and short term is essential to determine the rate of tax which may be applied on the capital gains. The classification depends upon the period of holding of the capital asset.

  For the purpose of Section 45(4), should the period of holding be considered from the date the person became the partner of the firm or should it be counted based on the time capital was introduced by the partner in the firm. There is ambiguity in this regard in the provisions.

  Without clear guidance in this aspect, it is practically not possible to determine the tax amount. With this implication, can it be said that no capital gain tax is to be paid as the computational machinery becomes inoperative? It will be an interesting question to watch out for.

- ***Taxation on receipt of money by a partner at the time of dissolution*** – Section 45(4) covers cases of reconstitution only and not the cases of dissolution. Whether without explicit mention in the provision, Taxman can argue that even the cases of dissolution will be covered under the term 'reconstitution'? This issue may also have wide ramifications.

Conclusion

The amendments brought about by the Finance Act, 2021 will resolve quite a few issues which were the subject matter of litigation in the past. However, the issues have been resolved mostly in favour of the taxman.

Having said that, the new provisions also have certain open issues for which it is important that CBDT provides appropriate clarifications. Else, the time is not far when we get to see a new round of litigation in partnership taxation.

[The authors are Senior Associate and Associate respectively, in Direct Tax practice, Lakshmikumaran & Sridharan Attorneys, New Delhi]

Notifications & Circulars

Relaxation in time limits under Income-tax law due to COVID-19 pandemic

In view of COVID-19 pandemic in India, due-dates for compliance, assessment, and appeals have been extended. A summary of various notifications and circulars issued recently by the CBDT are available in L&S Direct Tax Update No. 21 of 2021. The Update is available here.

Faceless appeal scheme applicable only for Income-tax

The CBDT *vide* Circular dated 7 April 2021 has clarified that the Faceless Appeal Scheme, 2020 would only be applicable to the Income-

© 2021 Lakshmikumaran & Sridharan, India
All rights reserved

tax Act and not to any other Direct tax laws including the following:

- Wealth-tax Act, 1957;
- Interest-tax Act, 1974;
- Gift Tax Act, 1958;
- Expenditure-tax Act, 1987;
- Securities Transaction Tax in Chapter VII of Finance (No. 2) Act, 2004;
- Commodities Transaction Tax in Chapter VII of Finance Act, 2013; and
- Equalization Levy in Chapter VIII of Finance Act, 2016.

Thus, appellate proceedings relating to the aforesaid statutes will continue through physical mode and jurisdiction over them would lie with the Commissioners of Income-tax (Appeals).

Relaxation in master file and country-by-country report (CbCR) compliances

Vide Notification No. 31 dated 5 April 2021 the CBDT has introduced Income-tax (9th Amendment) Rules, 2021 to amend Rules 10DA (relating to Master File) and 10DB (relating to CbCR) of Income-tax Rules, 1962 ('**IT Rules**'). These amendments in relation to Master File and CbCR Compliance requirement are summarized below.

A. Relaxation in Master File compliance:

Earlier, Rule 10DA(4) of the IT Rules provided that where there were one or more constituent entities residents in India of an international group, then any one constituent entity designated by the international group may furnish the Master File i.e. Form 3CEAA with Indian Authorities. The non-resident entities were however required to furnish the master file individually.

In order to ease the compliance burden on MNE groups, Rule 10DA has been amended w.e.f April 1, 2021. Post amendment, **regardless of its residential status, any constituent entity** of an MNE group can be designated for filing master file with the Indian Authorities on behalf of the entire group.

B. Relaxation in CbCR compliance:

Earlier, Rule 10DB(6) of the IT Rules provided that designated constituent entity would be required to file Country-by-Country Report if the consolidated revenue of the group exceeds five thousand five hundred crore rupees.

In order ease the compliance burden on MNE Group, the said rule has been amended to increase the threshold limit for CbCR compliance to **six thousand four hundred crore rupees**.

The amendment is in line with threshold limit of Euro 750 million as prescribed in OECD TP Guidelines and BEPS Action Plan 13.

In addition to above, the notification also provides that concerned income tax authority for submission of Master File and CbCR shall be Joint Director instead of Joint Commissioner. These changes are effective from 1 April 2021.

Statement of Financial Transactions under Section 285BA – Formats, procedures and guidelines notified

Section 285BA of the IT Act and Rule 114E of the IT Rules require specified reporting persons to furnish Statement of Financial Transaction ('**SFT**'). *Vide* recent notifications, the CBDT has notified the guidelines for preparation and submission of SFT as well as the data structure

© 2021 Lakshmikumaran & Sridharan, India
All rights reserved

and validation rules for the following incomes/transactions:

- Dividend income *[Notification No. 1 of 2021]*
- Interest income *[Notification No. 2 of 2021]*
  - For the above two, SFT shall be furnished on or before the 31 May, immediately following financial year in which the transaction is registered or recorded.
- Depository transactions *[Notification No. 3 of 2021]*
- Mutual Fund Transactions by Registrar and Share Transfer Agent *[Notification No. 4 of 2021]*
  - For the above two, SFT relating to FY 2020-21 to be furnished on or before the 31 May 2021.
  - Thereafter, SFTs relating to the quarter ending on 30 June, 31 September, 31 December and 31 March to be furnished on or before 25 of July, October, January and April respectively.

Exemption under Section 10(23FE) to pension funds – Conditions revised

Section 10(23FE) was introduced *vide* Finance Act, 2020 to provide exemption to sovereign wealth funds and pension funds on dividend income, interest income and long-term capital gains arising from investments in the infrastructure sector in India. In addition to the conditions laid down in this regard in the section, Rule 2DB of the IT Rules lays down the additional conditions which must be fulfilled by pension funds in order to avail the exemption. The said rule has been amended *vide* Notification No. 32 of 2021, dated 15 April 2021 and Notification No. 37 of 2021, dated 26 April 2021.

As per sub-clause (iv) of clause (c) of the Explanation to Section 10(23FE), for a pension fund to avail the said exemption, it must be specified by the Central Government, by notification in the Official Gazette. In order to apply for such notification, a pension fund is required to furnish Form 10BBA before the competent authority. The said form has been substituted by Notification No. 37 of 2021, dated 26 April 2021.

Mechanism for withdrawal of applications filed before Income-tax Settlement Commission notified

An important amendment brought about through the Finance Act, 2021 is the discontinuance of the Income-tax Settlement Commission with effect from 1 February 2021. By virtue of the newly inserted Section 245M, an option had been given to applicants to withdraw the pending applications. *Vide* Notification No. 40 of 2021, dated 30 April 2021, the CBDT has introduced Rule 44DA and prescribed Form No. 34BB to allow applicants to exercise the option to withdraw pending applications. The said form must be furnished electronically and be verified by the person who is authorised to verify the return of income.

Thresholds of Significant Economic Presence defined

The CBDT has *vide* Notification No. 41 of 2021, dated 3 May 2021 inserted Rule 11UD in the IT Rules to lay down the thresholds for the purposes of 'significant economic presence', which has been defined in Explanation 2A to Section 9(1)(i) of the IT Act. As per Rule 11UD:

© 2021 Lakshmikumaran & Sridharan, India
All rights reserved

- For the purposes of clause (a) of the said Explanation 2A, the amount of aggregate of payments arising from transactions in respect of any goods, services, property, provision of download of data or software in India carried out by a non-resident with any person in India during the previous year shall be INR 2 crore.
- For the purposes of clause (b) of the said Explanation 2A, the number of users with whom systematic and continuous business activities are solicited or who are engaged in interaction shall be three lakh.

No PAN required by eligible foreign investors

Rule 114AAB of the IT Rules lays down the class or classes of persons to whom the provisions of Section 139A do not apply and thus, there is no requirement for them to obtain a PAN. *Vide* Notification No. 42 of 2021, dated 4 April 2021, the CBDT has inserted a new sub-rule (2A) to provide that Section 139A would not apply to those non-residents who are eligible foreign investors and '*have made transaction only in a capital asset referred to in section 47(viiab) which are listed on a recognised stock exchange located in any International Financial Services Centre and the consideration on transfer of such capital asset is paid or payable in foreign currency*', subject to the fulfilment of the conditions specified therein.

Rules of cash allowance in lieu of leave travel concession ('LTC') notified

Vide the Finance Act, 2021 a second proviso has been inserted into Section 10(5) of the IT Act to address situations where employees have not been able to undertake travel due to COVID-19 and therefore, avail the benefit of LTC. It states that for AY 2021-22 "*the value in lieu of any travel concession or assistance received by, or due to, such individual shall also be exempt under this clause subject to the fulfilment of such conditions (including the condition of incurring such amount of such expenditure within such period), as may be prescribed.*"

Consequently, *vide* Notification No. 50 of 2021, dated 5 April 2021, the CBDT has prescribed the relevant rules for this purpose by inserting sub-rule (1A) in Rule 2B of the IT Rules.

Rule 2B(1A) provides that where an employee avails any cash allowance from his employer in lieu of LTC, the exemption under the second proviso shall be for an amount, not exceeding the lower of INR 36,000 per person (for the employee and his/her family members) or 1/3rd of the specified expenditure, subject to fulfilment of conditions provided therein.

The term 'specified expenditure' has been defined to mean expenditure incurred by an employee or any of his family member during the period between 12 October 2020 and 31 March 2021 on goods or services, procured from GST registered vendors, which are liable to GST at an aggregate rate of 12% or above.

Sub-rule (1B) has also been inserted to provide that if the exemption under the second proviso to Section 10(5) is claimed and allowed, the exemption under sub-rule (1) for LTC shall be available in respect of only one journey during the block period.

© 2021 Lakshmikumaran & Sridharan, India
All rights reserved

Ratio Decidendi

India-Netherlands DTAA – Benefit under MFN clause available from date when third country became OECD member

In a writ petition filed before the Delhi High Court, the petitioners were companies which were resident of the Netherlands. They had applied for a lower withholding tax certificate under Section 197 of the IT Act by placing reliance on Most Favoured Nation ('**MFN**') clause laid down in the Protocol to the India-Netherlands DTAA. Ignoring the Protocol, the Income Tax Department issued a withholding certificate requiring the deductor to withhold tax on dividend at the rate of 10% in accordance with Article 10(2) of DTAA. This withholding certificate was challenged by the petitioners before the High Court.

The Court on a perusal of the Protocol observed that it forms an integral part of the DTAA. No separate notification is required for the Protocol to be applicable. As per the Court, the MFN clause contained therein would automatically apply to the DTAA in question, provided the following conditions are satisfied:

- India should have a treaty with a third country, and India should have agreed to a limited/restricted scope or rate of withholding tax therein as opposed to the DTAA with the MFN clause; and
- the third country mentioned above should be a member of the OECD.

The Court rejected the contentions of the Revenue that the beneficial provisions of DTAAs entered into with third countries which were entered either prior to or after the coming into force of the India-Netherlands DTAA could not be made applicable to the persons covered by it. It also held that the fact that the third country was not a member of OECD as on the date of coming into force of the India-Netherlands DTAA would not affect the applicability of the MFN clause.

Applying the rules of treaty interpretation, the Court held that since the India-Solvenia DTAA was fulfilling both the aforesaid conditions, the beneficial rate, i.e. 5% prescribed therein would apply to India-Netherlands DTAA as well. However, the beneficial rate would apply from the date when Solvenia became an OECD member and not from the date when DTAA between India and Solvenia came into force.

Thus, the Court set aside the withholding tax certificate issued by the Income Tax Department and directed the tax authorities to issue a fresh certificate at the rate of 5%. [*Concentrix Services Netherlands B.V.* v. *Income Tax Officer (TDS) and Anr.* – Order dated 22 April 2021 in W.P.(C) 9051/2020, Delhi High Court]

Issue of shares at face value during amalgamation not attracts Section 56(2)(viib)

To achieve better utilization of resources, higher return on capital and economy of scale, the assessee (referred to as amalgamated company) entered into a scheme of amalgamation with another company (referred to as amalgamating company). Pursuant to the scheme of amalgamation, amalgamating company transferred all its assets and liabilities to the assessee. In consideration for the transfer of these assets and liabilities, the assessee issued shares to the shareholders of the amalgamating company. Consequentially, the difference

© 2020 Lakshmikumaran & Sridharan, India
All rights reserved

between the value of net assets and the value of shares issued was booked as 'Capital Reserve' by the assessee.

During assessment, the AO was of the view that since the net value of assets received by the assessee exceeded face value of the shares issued by it, it had received excess consideration for the issuance of its shares. Accordingly, it was observed that the excess consideration received by the assessee would be subject to tax under Section 56(2)(viib) of the IT Act. On appeal, CIT(A) reversed the order of AO.

On second appeal, the ITAT referred to the Memorandum explaining Finance Bill, 2012, the Finance Minister's speech and the Explanatory Circular issued by the CBDT to hold that Section 56(2)(viib) intends to tax excess share premium received by private companies on issue of shares without carrying underlying value to support such premiums, thereby enriching the issuing company without paying their legitimate tax dues. To curb such practices, Section 56(2)(viib) created a deeming fiction to convert a capital receipt into revenue income. Having made this observation, the ITAT held that a legal fiction is limited by the purpose for which it is created; it cannot be stretched beyond such purpose and import another fiction.

Considering the object and intent of the deeming provision, ITAT held that Section 56(2)(viib) would not be applicable in the assessee's case, since it had not charged any premium on the issuance of shares, and rather had issued the shares at face value.

The ITAT also observed that a scheme of amalgamation is a tripartite arrangement between the amalgamating company, the shareholders of the amalgamating company and the amalgamated company. Therein, the assets and liabilities of the amalgamating company are vested with the amalgamated company, whereas the shares are issued to the shareholders of the amalgamating company. After considering this and considering the proviso to Section 56(2)(viib), the ITAT held that Section 56(2)(viib) is not applicable in case of amalgamations. [*DCIT* v. *Ozone India Ltd*. – Order dated 13 April 2021 in ITA No. 2081/Ahd/2018, ITAT Ahmedabad]

1. India-UAE DTAA – Residential status of director irrelevant if non-resident assessee incorporated, controlled and managed in UAE

2. Limitation of Benefit ('LoB') provision when cannot be invoked

The assessee-company was incorporated in UAE and was engaged in the business of chartering ships for the transportation of goods in international waters. During the year under consideration, it received freight from its operations at Indian ports. The assessee contended that since it was a resident of UAE, as per Article 8 of the India-UAE DTAA, its income from such operations would not be taxable in India.

The AO rejected this claim of the assessee by stating that the business of the assessee was controlled by a Greek national and that there is nothing to show that he was residing in UAE for more than 183 days, leading to the inference that the business of the assessee was not being managed or controlled from UAE. The AO placed reliance on *Vodafone International Holdings BV* v. *UoI* [(2012) 341 ITR 1 (SC)] to hold that the assessee was simply a colourable device for tax avoidance by availing treaty benefits, since its owner was a Greek national.

The objections of the assessee were rejected by the DRP which held that the AO had correctly relied on the limitation of benefits provision i.e. Article 29 of the DTAA.

© 2021 Lakshmikumaran & Sridharan, India
All rights reserved

In appeal, the ITAT held that the evidences on record such as the assesse's office being in UAE, UAE work permits of expatriate employees, proof of residence of Greek national in UAE etc. showed that it was controlled and managed in UAE. It was further held that residential status of a director of a company (i.e. the Greek national) was in any case immaterial while determining if business was being carried out from UAE. The requirement of period of stay was only applicable to individual assessees and not to directors of a company. Since the assessee was a company incorporated in UAE and was conducting its business from UAE, it was a resident of UAE as per Article 4 of the DTAA.

Ruling out the applicability of Article 29 (Limitation of Benefit) of the DTAA, the ITAT held that while the company had been in business since 2000, the DTAA became operational in 2015. Therefore, it cannot be held that the 'main purpose of creation of such an entity was to obtain the benefits'. It was accordingly held that the assessee was eligible for treaty protection, in respect of its income earned in India. [*Interworld Shipping Agency LLC* v. *DCIT* - Order dated 30 April 2021 in ITA No. 7805/Mum/2019, ITAT Mumbai]

No liability to withhold tax on a transaction conducted prior to insertion of Explanation 2 to Section 195 despite its retrospective application

The assessee-company was a Mauritian resident, which had on 11 July 2008 purchased the shares of a Singapore entity from its parent which was a resident of the UK. The said Singapore entity in turn held three Indian subsidiaries, two of which were amalgamated into an Indian group company of the assessee.

The AO was of the view that the pre-dominant purpose behind the assessee's acquisition of the shares of the Singapore entity was to acquire the underlying assets i.e. its Indian subsidiaries. Applying Explanation 5 to Section 9(1)(ii) of the IT Act, the AO held that the shares of the Singapore entity derived their value substantially from the assets located in India, and thus, capital gains arising from the said transaction were taxable in India. Further, the AO noted that Explanation 2 to Section 195, which had been inserted *vide* Finance Act, 2012, was retrospectively applicable from 1 April 1962. Thus, the AO held that the assessee had defaulted by not withholding tax on the consideration paid under Section 195. Consequently, demand was raised, and interest imposed under Section 201(1A) of the IT Act.

In appeal, the CIT(A) deleted both the demand and the levy of interest. Aggrieved by the same the Department filed an appeal before the ITAT.

The ITAT, without getting into the taxability of the underlying transaction, upheld the order of the CIT(A) on both counts. The ITAT placed reliance on *Engineering Analysis Centre of Excellence* v. *CIT* [(2021) 125 taxmann.com 42 (SC)] to hold that since Explanation 2 to Section 195 had been inserted into the IT Act after the transaction in question had already taken place, it was impossible for the assessee to withhold tax while paying the consideration for the share purchase. Thus, the assessee could not be faulted for non-deduction of tax. The ITAT also held that since there was no liability on the assessee to deduct tax at source under Section 195, there could also not be any liability to pay interest under Section 201(1A) of the IT Act. [*DCIT* v. *WNS Capital Investment Limited, Mauritius* - Order dated 30 April 2021 in ITA No. 3851/Mum/2018, ITAT Mumbai]

© 2021 Lakshmikumaran & Sridharan, India
All rights reserved

Beneficial rate provided in DTAA for taxation of dividends to prevail over rate provided in Section 115-O

The assessee was an Indian company which had made the payment of dividend to a company that was tax resident of Malaysia. The question before the ITAT was whether the tax payable by the assessee under Section 115-O of the IT Act was to be computed as per the rate provided in the said section or the beneficial rate prescribed in the India-Malaysia DTAA for taxation of dividends.

Answering the same, the ITAT held that DDT is a tax on dividend income and not the undistributed profits of the company paying dividends. Till the time dividends are declared, the undistributed profits constitute the income of the company and not the shareholders.

Section 115-O transfers the incidence of tax in the hands of the resident company paying the dividends only for administrative ease. Dividends constitute the income of the shareholders and are therefore chargeable to tax as per Section 4 of the IT Act. It held that as per the provisions of Section 4, the income tax, including the additional income tax, is chargeable at the rate specified in the IT Act or DTAA, whichever is beneficial to the assessee.

In conclusion, the ITAT held the beneficial rate prescribed in the DTAA shall prevail over the one provided in Section 115-O of the Act if the following conditions are satisfied: (a) dividend is paid to the non-resident shareholder; (b) dividend constitutes income in the hands of the non-resident shareholder; (c) non-resident shareholder is the beneficial owner of the dividend; and (d) non-resident shareholder does not have a permanent establishment in India.

While arriving at the above conclusion, the ITAT also analyzed the decisions of the Supreme Court in *Union of India* v. *Tata Tea Co. Ltd.* [(2017) 251 Taxman 10 (SC)] and *Godrej & Boyce Manufacturing Company Ltd.* v. *DCIT* [(2017) 247 Taxman 361 (SC)] and held that the said decisions were not contrary to each other since both laid down that taxability of an income must be considered from the perspective of the recipient and not the payer thereof. Thus, the rate of DDT must be decided from the perspective of the shareholder even though the incidence of tax has been placed on the company paying the dividend.

The ITAT placed reliance on decisions in the case of *Giesecke & Devrient [India] Pvt Ltd.* v. *Addl. CIT* [ITA No. 7075/Del/2017] and *Reckitt Benkiser (I) Pvt. Ltd.* v. *DCIT* [ITA No. 404/Kol/2015]] and held that the beneficial rate provided in the DTAA would apply to dividend distributed by company to non-resident shareholders and not the rate specified in Section 115-O of the IT Act. Accordingly, the matter was remitted for fresh adjudication and examination of relevant article of the DTAA. [*DCIT* v. *Indian Oil Petronas Pvt. Ltd.* - Order dated 30 April 2021 in I.T.A. Nos. 1884 & 1885/Kol/2019, ITAT Kolkata]

© 2021 Lakshmikumaran & Sridharan, India
All rights reserved

NEW DELHI
5 Link Road, Jangpura Extension,
Opp. Jangpura Metro Station,
New Delhi 110014
Phone : +91-11-4129 9811

B-6/10, Safdarjung Enclave
New Delhi -110 029
Phone : +91-11-4129 9900
E-mail : lsdel@lakshmisri.com

MUMBAI
2nd floor, B&C Wing,
Cnergy IT Park, Appa Saheb Marathe Marg,
(Near Century Bazar)Prabhadevi,
Mumbai - 400025
Phone : +91-22-24392500
E-mail : lsbom@lakshmisri.com

CHENNAI
2, Wallace Garden, 2nd Street
Chennai - 600 006
Phone : +91-44-2833 4700
E-mail : lsmds@lakshmisri.com

BENGALURU
4th floor, World Trade Center
Brigade Gateway Campus
26/1, Dr. Rajkumar Road,
Malleswaram West, Bangalore-560 055.
Phone : +91-80-49331800
Fax:+91-80-49331899
E-mail : lsblr@lakshmisri.com

HYDERABAD
'Hastigiri', 5-9-163, Chapel Road
Opp. Methodist Church,
Nampally
Hyderabad - 500 001
Phone : +91-40-2323 4924
E-mail : lshyd@lakshmisri.com

AHMEDABAD
B-334, SAKAR-VII,
Nehru Bridge Corner, Ashram Road,
Ahmedabad - 380 009
Phone : +91-79-4001 4500
E-mail : lsahd@lakshmisri.com

PUNE
607-609, Nucleus, 1 Church Road,
Camp, Pune-411 001.
Phone : +91-20-6680 1900
E-mail : lspune@lakshmisri.com

KOLKATA
2nd Floor, Kanak Building
41, Chowringhee Road,
Kolkatta-700071
Phone : +91-33-4005 5570
E-mail : lskolkata@lakshmisri.com

CHANDIGARH
1st Floor, SCO No. 59,
Sector 26,
Chandigarh -160026
Phone : +91-172-4921700
E-mail :lschd@lakshmisri.com

GURUGRAM
OS2 & OS3, 5th floor,
Corporate Office Tower,
Ambience Island,
Sector 25-A,
Gurgaon-122001
Phone : +91-124-477 1300
E-mail : lsgurgaon@lakshmisri.com

PRAYAGRAJ (ALLAHABAD)
3/1A/3, (opposite Auto Sales),
Colvin Road, (Lohia Marg),
Allahabad -211001 (U.P.)
Phone : +91-532-2421037, 2420359
E-mail : lsallahabad@lakshmisri.com

KOCHI
First floor, PDR Bhavan,
Palliyil Lane, Foreshore Road,
Ernakulam Kochi-682016
Phone : +91-484 4869018; 4867852
E-mail : lskochi@laskhmisri.com

JAIPUR
2nd Floor (Front side),
Unique Destination, Tonk Road,
Near Laxmi Mandir Cinema Crossing,
Jaipur - 302 015
Phone : +91-141-456 1200
E-mail : lsjaipur@lakshmisri.com

NAGPUR
First Floor, HRM Design Space,
90-A, Next to Ram Mandir, Ramnagar,
Nagpur - 440033
Phone: +91-712-2959038/2959048
E-mail : lsnagpur@lakshmisri.com

Disclaimer: *Direct Tax Amicus* is meant for informational purpose only and does not purport to be advice or opinion, legal or otherwise, whatsoever. The information provided is not intended to create an attorney-client relationship and not for advertising or soliciting. Lakshmikumaran & Sridharan does not intend to advertise its services or solicit work through this newsletter. Lakshmikumaran & Sridharan or its associates are not responsible for any error or omission in this newsletter or for any action taken based on its contents. The views expressed in the article(s) in this newsletter are personal views of the author(s). Unsolicited mails or information sent to Lakshmikumaran & Sridharan will not be treated as confidential and do not create attorney-client relationship with Lakshmikumaran & Sridharan. This issue covers news and developments till 14 May 2021. To unsubscribe, e-mail Knowledge Management Team at **newsletter.directtax@lakshmisri.com**

www.lakshmisri.com **www.gst.lakshmisri.com**
www.addb.lakshmisri.com **www.lakshmisri.cn**

© 2021 Lakshmikumaran & Sridharan, India
All rights reserved