MPC & CO LLP
CHARTERED ACCOUNTANTS

Corporate Update

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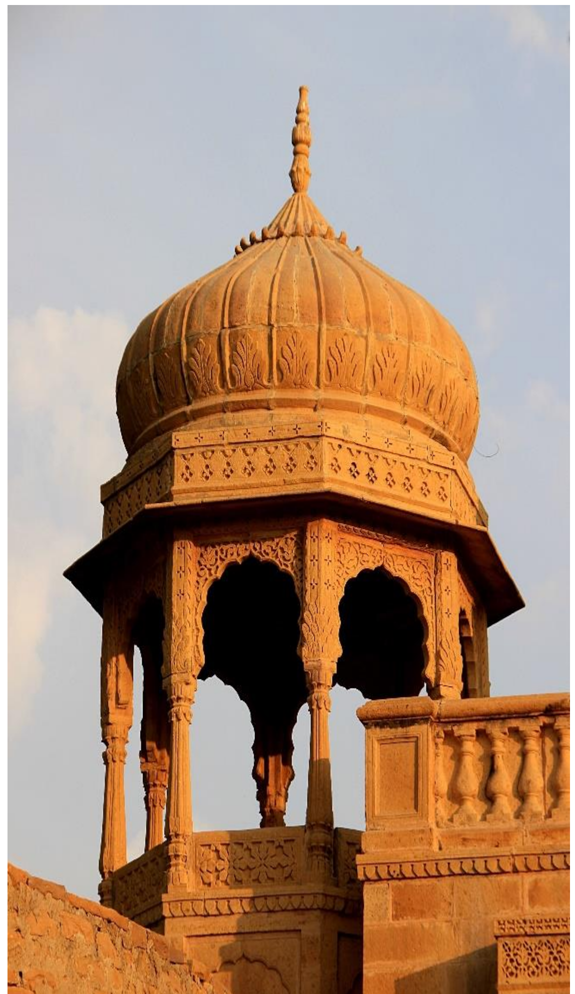

FOREWORD

Dear Reader,

This Corporate Update contains important decisions on International and Domestic taxation as well as on other important subjects.

The new Government, it is expected, would be formed on completion of voting for the elections to the Indian Parliament on first of next month and thereafter it is expected that the newly elected Government will present its full Annual Budget for the fiscal year ended March 31, 2025, next month, which will reflect the policies of the new Government on various subjects, including taxes and duties. We will cover the same in our next Update.

C.S. Mathur
Partner

DIRECT TAXES

INTERNATIONAL TAXATION

CASE LAWS

If profit attribution rate adopted in earlier years not questioned by the Revenue, no justification for issuing withholding tax certificate at a higher rate

GE Energy Parts Inc [TS-263-HC-2024(DEL)]

Recently, the High Court of Delhi in the above judgment, has held that if the tax authorities have consistently adopted the same profit attribution rate during past assessment proceedings and withholding tax certificate proceedings (197 proceedings) wherein a rate of 1.5% was issued, there is no justification in issuing a higher withholding tax rate of 4% in the current year, if the attribution rate was not disputed.

On facts, the assessee is a company incorporated in the US and a tax resident of US. It entered into contracts with various Indian customers for the supply of spare parts from outside India. The taxpayer had sought lower withholding tax certificate from tax authorities for FY 2022-23 and FY 2023-24. Before the tax authorities, it was contended that the assessee did not have a Permanent Establishment (PE) in India and that income from offshore supplies was not liable to tax in India. However, the tax authorities issued a withholding tax rate of 4% against which a writ petition was filed before the High Court of Delhi.

The High Court noted that in the assessment proceedings for AYs 2001-02 to 2008-09, the Revenue held that the taxpayer had a PE in India. It also noted that the tax authorities presumed a profit rate of 10% (based on Sections 44BB and 44BBB) and thereupon, attributed 35% of such profits to the PE.

In line with the aforesaid analogy, even in the 197 proceedings, the tax authorities issued a lower withholding tax rate of 1.5%. This practice was followed consistently for FYs 2010-11 up to FY 2020-21. It was also noted that upon the assessment orders being contested, the Tax Tribunal reduced the attribution rate of 35% to 26%, which was subsequently affirmed by the High Court.

The High Court observed that while the Revenue did not dispute the attribution rate of 26%, yet it proceeded to issue the lower withholding tax certificate at 4%. The High Court held that when the Revenue did not seriously question the attribution rate of 26%, the withholding tax rate could not exceed 1.04%.

As such, the High Court allowed the writ petition and quashed the withholding tax certificate. It is apt to mention that the High Court did caution that the decision taken for FYs 2022-23 and 2023-24 (to which the instant writ related) shall not be treated as a precedent for subsequent years.

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Business development days, vacation period and common days to be excluded from the threshold limit for 'Service PE'

Clifford Chance PTE Ltd. v ACIT [2024] 160 taxmann.com 424(Del-Trib)

In the above recent judgment, the Tax Tribunal, Delhi bench held that to compute the duration threshold for Service PE, days relating to vacation and business development were to be excluded.

On the facts of the case, the Singapore based company provided legal advisory services to international clients including Indian clients. Some services were rendered virtually and some services were rendered physically in India by the Singapore company's employees. Out of the total presence of 120 days in India, 36 days were spent on vacation and 35 days for business development. Furthermore, 5 days were common days spent by more than one individual.

The Singapore Company adopted a position that incidence of a PE does not arise in terms of Article 5(6)(a) of India- Singapore DTAA ('tax treaty'). However, the tax authorities concluded that the Singapore company constituted a Service PE based on the basis of physical presence of employees in India as well as a virtual Service PE. Having held so, the tax authorities attributed 100% of gross receipts relating to service activities to the Service PE.

Before the Tax Tribunal, the Singapore company argued that a Service PE does not exist as the aggregate stay of the employees in India was only 44 days, which is less than 90 days as stipulated in Article 5(6)(a) of the tax treaty. The Tax Tribunal held as under:

- In the absence of any provisions for virtual service PE in the present provisions of the DTAA, only actual physical rendition of services could constitute a Service PE. The Tax Tribunal relied on the OECD Interim Report, 2018 which supported this view.

- As regards vacation days, the Hon'ble Tribunal, while placing reliance on the decision of *Linklaters v. DDIT* [2019] 106 taxmann.com 195 (Mum. - Trib.), held that such days ought to be excluded for the purpose of the duration threshold.

- Furthermore, as regards business development days, the Tribunal held that no services were provided to customers in India on these days and hence, must be excluded.

- As regards common days, the Tribunal held that the computation threshold should not be calculated by aggregating man days spent by more than one individual.

After excluding the aforesaid days, the Tribunal held that the services were performed in India only for 44 days in India, which was less than the 90 days threshold stipulated in Article 5(6)(a) of the DTAA. Accordingly, a Service PE in India is not constituted in the hands of the Singapore company. As such, in the absence of a PE, it was held that the revenue from legal advisory services, being in the nature of business profits, was not taxable in India.

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PRESS RELEASE

CBDT enters into 125 Advance Pricing Agreements (APA) in FY 2023-2024

[CBDT Press Release dated April 16, 2024]

During the financial year 2023-24, CBDT has entered into 125 APAs which include 86 unilateral APA's and 39 Bilateral APA's with the Indian taxpayers. This marks the highest number of APAs since the launch of APA programme and represents a 31% increase compared to 95 APAs entered during preceding financial year. The total number of APAs since inception have now gone upto 641, comprising 506 Unilateral APAs and 135 Bilateral APAs.

The Bilateral APAs were signed as a consequence of entering into Mutual Agreements with India's treaty partners namely Australia, Canada, Denmark, Japan, Singapore, the UK, and the US.

The APA Scheme endeavours to provide certainty to taxpayers in the domain of transfer pricing by specifying the methods of pricing and determining the arm's length price of international transactions in advance for a maximum of five future years and the tax payer has an option to roll back the APA for four preceding years **as a result of which tax certainty is available for nine years** as a result of which, tax certainly is provided for Nine years The APA also provide taxpayers with protection from any anticipated or actual double taxation.

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DOMESTIC TAXATION

CASE LAWS

Revenue authority is not empowered to change the share valuation method adopted by the Assessee

Agra Portfolio (P.) Ltd. vs. Principal Commissioner of Income-tax – [2024] 161 taxmann.com 303 (Delhi)

In a recent decision, the Delhi High Court has held that the option to choose the angel tax valuation method rests solely with the Assessee. Revenue is allowed to scrutinize and undertake determination of Fair Market Value ('FMV') of shares by itself or through an independent valuer based on the valuation method adopted by the Assessee.

During Financial Year 2013-14, the Assessee had issued shares at premium. For the purpose of valuation of shares, the Assessee relied upon a valuation report issued by a Merchant Banker. During the scrutiny proceedings, the Assessing officer ('AO') rejected the valuation report on the ground that the Assessee neither corroborated the basis of valuation adopted in the report nor furnished any evidence in support of the figures mentioned in such report. Even the disclaimers given by the merchant banker were perceived adverse by the AO. As such, the AO determined the value of shares independently on the basis of Net Asset Value ('NAV') method rather than Discounted Cash Flow ('DCF') method adopted in the valuation report.

On appeal, the order of the AO was sustained by the Commissioner (Appeals) and the Tax Tribunal.

On an appeal before the Delhi High Court, the Assessee submitted that as per conjoint

reading of Section 56(2)(viib) and Rule 11UA of the Indian tax law, it is clear that the option of choosing a method of valuation stands vested exclusively in the assessee. In support of this submission, the Assessee relied on a decision of Bombay High Court in the case of *Vodafone M-Pesa Limited vs. PCIT (2018 SCC OnLine Bom 21317)*, wherein, it was held that it is not open to AO to change the valuation method opted by the Assessee. The Bombay High Court had observed that the language of statute places a choice upon the assessee to either follow NAV Method or obtain a Valuation Report drawn by a merchant banker as per the DCF method.

On the other hand, the tax department argued that the Section 56(2)(viib) of Indian tax law places the assessee under an obligation to submit a report depicting the FMV of shares and which can be duly substantiated to the satisfaction of the AO. The tax department submitted that in the instant case, the Assessee failed to establish the correctness of the valuation, therefore, the AO became entitled to undertake an independent exercise for the purposes of determining the FMV of the unquoted equity shares.

The Court also agreed with the view of the Assessee that in terms of Section 56(2)(viib) read with Rule 11UA of the Indian tax law, the option and the choice stands vested solely in the hands of the assessee. While acknowledging the decision of Bombay High Court in the case of *Vodafone M-Pesa Limited (supra)*, the Delhi High Court laid down that the statute does not appear to empower AO to independently evaluate the value of the equity shares by adopting a valuation method other than the one chosen by the assessee.

The Court further noted that the above view as taken by the Bombay High Court in the above-mentioned judgment, has been consistently followed by the Tax Tribunals of different jurisdictions.

Based on above, the Delhi High Court remitted back the matter to the AO directing him to undertake an exercise of valuation afresh in accordance with the DCF method. The Court also allowed the determination of FMV of shares by an independent valuer bearing in mind that the Assessee has adopted the DCF method.

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Placing Notice on Income Tax E-Portal is not a prescribed mode of communication of notice to the assessee

In a recent Writ Petition filed in the case of **Munjal BCU Centre of Innovation and Entrepreneurship v/s. Commissioner of Income Tax Exemptions, Chandigarh [TS-231-HC-2024(P & H)],** the High Court of Punjab and Haryana has held that the income tax provisions do not mention communication to be “presumed” by placing notice on the e-portal.

In the instant case, the Commissioner of Income Tax (Exemption), Chandigarh [CIT(E)] issued a show cause notice to the assessee for initiating proceedings under Section 12A(1)(ac)(iiii) [for denial of registration] which was only placed on the e-portal of the Income Tax Department and was not sent on the assessee’s email or otherwise. Subsequently, two reminders of

the aforesaid show cause notice were reflected only on the Income Tax Department's e-portal and were not sent on the assessee's email or otherwise.

The Department submitted that communication of the notice electronically would also include communication of notice by placing it on e-portal and as the assessee submitted his form (for registration) himself on the said e-portal, a presumption could be drawn that the assessee was having knowledge of the notice/ reminders which were published on the said e-portal, as there was no requirement of serving notice/ reminders through assessee's email or otherwise.

The High Court relying on Section 282(1) and Rule 127(1) of the Act stated that the communication of notice must be in terms of the provisions of section 282(1) of the Act read with Rule 127(1) and the provisions do not mention communication to be "presumed" by placing notice on the Income Tax Department's e-portal. The assessee is not expected to keep the said e-portal open at all times so as to have knowledge of what the Income Tax Department is supposed to be doing with regard to submissions of forms etc. The High Court therefore, directed the CIT(E) to pass a fresh order after granting sufficient opportunity to the assessee to file his reply. As such, the Writ Petition was allowed.

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Premium received at the time of redemption of 'Non-Convertible Debentures' is taxable as interest and not capital gains

Khushaal C. Thackersey v. ACIT [I.T.A No. 3679/Mum/2015]

Recently the Mumbai Bench of the Income Tax Appellate Tribunal has held that premium/surplus realized by the taxpayer upon the redemption on maturity of Non-Convertible Debentures ("NCD") would give rise to interest income taxable as 'Income from Other Sources'. The Tribunal rejected the contention of the taxpayer that such gain is taxable as Long- Term Capital Gains.

On facts of the case, an Indian company (Hindoostan Spinning & Weaving Mills Ltd) was declared as a sick unit and was later managed by three Special Purpose Vehicles ("SPVs") as per the Scheme Sanctioned by BIFR for their revival. The assessee in the present case was a director in one of the SPVs. The three SPVs issued 0% secured redeemable NCDs payable at a premium after 5 years to the secured lenders i.e. Nationalized Banks in lieu of outstanding loans as per the Sanctioned Scheme. The SPVs were not required to pay interest during the tenure of the NCDs since the NCD carried 0% interest; only the premium was to be paid on redemption.

However, before the maturity, in 2006, the NCDs were purchased by the directors (including taxpayer) of SPVs. Such NCDs were redeemed on maturity in 2009 by the directors.

At the time of redemption, the taxpayer made a gain and offered the same as Long Term Capital Gains ("LTCG") in the return of income. The taxpayer also claimed deduction u/s 54F from such LTCG, which however was rejected by the tax officer

alleging non-fulfilment of the prescribed conditions.

The taxpayer appealed before the CIT(A). The CIT(A) however held the premium as interest income under Income from other sources rejecting the claim of taxability as LTCG made the taxpayer. The CIT(A) also observed that 'redemption' would not fall under the definition of 'transfer' under the Income tax Act.

On appeal by the taxpayer against the order of CIT(A), the Tribunal held that such premium shall be chargeable to tax as interest income only and not as capital gains. The contentions of the taxpayer / tax department and decision of ITAT are summarized hereunder:

Contentions of the taxpayer

- The contention of the taxpayer was that a 'debenture' is a capital asset and its redemption results in extinguishment of rights therein.

- Reliance was placed by the taxpayer on the decisions of Supreme Court wherein it was held that redemption of 'preference share' is considered as 'transfer' of a 'capital asset'. Support was also drawn from the decision of the ITAT wherein the redemption of capital investment bond after maturity was held to be a 'transfer'.

- The taxpayer quoted the provisions of section 50AA ,as per which the gains arising on transfer, redemption or maturity of 'market linked debentures' are deemed as Short Term Capital Gains, and an analogy was drawn that debenture is recognized as a capital asset under the legislation.

Contentions of the tax authorities

- NCDs are debt instruments and issuing of debentures is one of the ways of borrowing money either from market or through private placement.

- The NCDs carried 0% interest rate but are redeemable at a premium. The premium was to be calculated in a specific manner thereby premium is nothing but the interest amount payable on the NCDs.

- Reliance was placed on the Mumbai Tribunal decision wherein it was held that the premium received on redemption of debenture is taxable under the head Income from other sources.

- Reference was also made to the Circular no. 002 of 2002 issued by the CBDT, wherein it is clarified that the difference between the redemption price and the cost of purchase of Deep Discount Bonds by the intermediate purchaser will be taxable as interest or business income, as the case may be. The tax department argued that the taxpayer is an intermediate purchaser and not the original subscriber to NCDs.

Key observations of the ITAT

- The Tribunal held that there is no dispute that debentures fall under the category of 'Capital asset' under the Act. The question of generation of capital gain would not arise when the debentures are redeemed by the issuing companies. However, in the present case, what is received by the assessee as premium is nothing but interest income only.

- Regarding section 50AA, the ITAT observed that this section is applicable

to a case of 'Market Linked Debentures' ('MLD). In the instant case the taxpayer purchased NCDs and they are materially different from MLDs.

- The court decisions quoted by the taxpayer are related to preference shares / equity shares and not to debentures. The shares and debentures are different type of instruments having different types of rights and liabilities.

- The redemption of debentures is nothing but repayment of debt and the same cannot fall under the category of extinguishment as interpreted by the courts in the case of shares / preference shares.

- As such, based on the above, the Mumbai Bench of ITAT held that the CIT(A) was right in treating the premium on redemption of NCDs as interest income.

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MISCELLANEOUS CASE LAWS

Applicability of requirement of contribution to Provident Fund on International Workers struck down by the Karnataka High Court – Karnataka High Court Order dated April 25, 2024 in WP No. 18486

[Karnataka High Court Order dated April 25, 2024 in EP No. 18486/2012 etc.]

Applicability of requirement of contribution to Provident Fund on International Workers struck down by High Court - Karnataka High Court decision dated 25th April, 2024 in setting aside the notification as contained in Para 83 of the EPF Scheme and Para 43A of the EP Scheme of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952.

1. Para 83 of the EPF Scheme extending the benefits of the Employees' Provident Fund Scheme under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 to international workers, was notified by the Govt. of India on 1st October 2008 w.e.f November 01, 2008. Similarly, the Govt. of India extended the Employees Pension Scheme to the International Workers by suitably inserting Para 43A in the Employees' Pension Scheme.

   "**International Worker**" for the purpose has been defined as under:

   "International Worker" means-
   In a recent decision in the case of **Principal Commissioner of Income Tax versus M/s. Weilburger Coatings (India) Pvt. Ltd. [TS-613-HC-2023 (CAL)],** the Calcutta High Court held that for the cases selected under limited scrutiny, scrutiny assessment proceedings should be confined only to the issues under limited scrutiny.

   a) **An Indian employee having worked or going to work in a foreign country with which India has entered into a social security agreement and being eligible to avail the benefits under a social security programme of that country, by virtue of the eligibility**

gained or going to gain, under the said agreement;

b) **An employee other than an Indian employee, holding other than an Indian passport, working for an establishment in India to which the Act applies.**

2. The extension of the above benefits to International Workers added to the cost of employers as well as to the individual International Worker.

3. Quite a few Writ Petitions were filed in the Karnataka HC in the years 2010, 2012, 2015, 2019 and 2021, by both the employers as well as the employees challenging the introduction of both the Schemes, to international workers, on various grounds.

4. The main arguments advanced by Writ Petitioners were as under:

   i. ***Introduction of para 83 and para 43A is opposed to the object and intendment of the Act;***
   ii. ***There is manifest arbitrariness in introducing para 83 and para 43A;***
   iii. ***The Act provides for coverage of the weaker sections where there is a ceiling limit of salary for eligibility. No salary ceiling limit for international workers is in contravention of the Act;***
   iv. ***Heavy burden is on the employer;***
   v. ***Para 83 and Para43A are unconstitutional and hit by Article 14 of the Constitution of India and also illegal being opposed to the object of the EPF & MP Act, 1952.***

5. On behalf of the Central Government and other respondents who opposed the Writ Petition, it was mainly stated as under:

   i. ***International workers form a separate class and the international workers encompasses an Indian employee having worked or working or going to work in a foreign country with which India has entered into a Social Security Agreement and being eligible to avail the benefits under the social security programme of that country;***
   ii. ***The Scheme is neither discriminative nor violative of Article 14 of the Constitution and by the process of classification, the State has the power to determine who should be regarded as a class for the purpose of legislation and in relation to law enacted on a particular subject;***
   iii. ***The classification is not arbitrary but rational. There is a nexus between the differentia which is the basis of classification and the object of the Act;***
   iv. ***The international workers considering their special status, in order to fulfil the international obligations, the Government of India has made special provisions for international workers, which is distinct from the employees covered under the Act. As the classification held to be based on intelligible differentia, which had a rational relation to the object sought to be achieved viz., the amelioration of the condition of service of international workers and therefore, the provisions made in the scheme are neither arbitrary nor discriminatory.***

6. Both sides relied upon a number of judicial precedents in the matter. But unfortunately, the High Court did not

analyse the ratio of even single decision cited before it.

7. However, it is stated that the High Court considered the contentions raised by the counsels on both sides and focused on the following issue:

"Whether introduction of Para 83 of EPF Scheme and Para 43A of EP Scheme is unconstitutional and hit by Article 14 of the Constitution of India".

Article 14 states as under:

Article 14: Equality before Law:

"The State should not deny to any person equality before the law or the equal protection of the laws within the territory of India".

The main interpretations of the above law are as under:

i. ***While Article 14 prohibits class legislation, it does not prohibit reasonable classification for the purposes of legislation. However, in order to pass the test of permissible classification, two conditions must be fulfilled, namely, (i) the classification must be founded on an intelligible differentia which distinguishes persons or things that are grouped together from others left out of the group and (ii) that the differentia must have a rational relation to the object sought to be achieved by the statute in question. The classification should be founded on a different basis, namely, geographical or according to the objects or occupations or the like;***

ii. ***What is necessary to be seen is that, there must be a nexus between the basis of the classification and the object sought to be achieved under the Act.***

8. A) The Court noted as regards the PF Scheme, as notified under Para 83, the following:

i. ***An international worker is required to contribute on his entire salary;***

ii. ***The amount at the credit of the international worker when he leaves India would be payable to him, only upon his attaining the age of 58 years.***

B) As regards the EP Scheme, as extended by Para 43A, the Court noted the following:

i. ***Contribution is payable on total salary payable on account of the employment of the employee. In other words, there is no cap on the salary on which contributions are payable by the employer as well as the employee;***

ii. ***If an Indian employee is employed in any covered establishment in India and sent abroad on posting, he is liable to be a member in India as a domestic Indian employee if otherwise eligible and in that case, he is not an international worker;***

iii. ***An Indian employee attains the status of international worker only when he becomes eligible to avail benefits under the social security programme of another country.***

C) The Court further noted that -

i. ***Para 83 of the EPF Scheme is in the nature of subordinate legislation and therefore, the***

subordinate legislation cannot travel beyond the scope of the mother Act. Keeping in view the aims and objects of the main EPF & MP Act, when a ceiling amount of Rs. 15,000/-per month has been placed as a threshold for an employee to be a member to the scheme, para 83 of the EPF Scheme ought not to have an unlimited threshold for international workers while denying the same benefit to Indian workers.

ii. ***An Indian employee working in a foreign country with SSA who is a member of EPF & MP Act, 1952 continues to contribute on meager sum of Rs. 15,000/- whereas, a foreign worker from SSA country, without a certificate of coverage, is made to contribute PF on his entire salary although both are by definition of international workers.***

9. The Court thus came to the following decisions:

    a) ***There is discrimination between the Indian employees working in a non-SSA country (who are not international workers as per definition) and foreign employees from a non-SSA working in India who are classified as international workers. There is no rational basis for this classification nor there is reciprocity that compels to classify foreign employees from non-SSA countries as international workers. The respondents neither have stated whether the Indian employees working in non-SSA countries nor required to contribute their entire pay without statutory limit towards PF of that country. In the absence of parity and also in the absence of reciprocity, there is no justification to demand a contribution on the entire pay of a foreign employee from a non-SSA country;***

    b) ***"The legislation has arbitrarily and unreasonably enacted para 83, the Government of India introducing para 83 of EPF Scheme and para 43A of EP Scheme is violative of Article 14 and the classification made is unreasonable and would defeat the very intent of the Act. The legislation cannot run beyond the parameters of the Parent Act and always there must be some principles to guide the exercise of discretion and for the foregoing reasons.***

10. On account of the above conclusions reached by the Hon'ble High Court, it allowed the Writ Petitions filed by the employers and employees.

11. **Critical analysis of the above outcome of the above High Court decision:**

    The relevant paras in the EPF Scheme (Para 83) and the Employees' Pension Scheme (Para 43A) have been struck down, being arbitrary and unreasonable and violative of Article 14 (Equality before Law) of the Constitution of India. Since the provisions have been struck down, the judgment would seem to take retrospective effect. However, the judgment seems to have effect only in the State of Karnataka, considering the constitutional territorial jurisdiction of a High Court. Such a restriction on the applicability of the above decision adds to the situation that it does not apply outside the State of Karnataka. In other States, the decision will have only persuasive value.

The judgment does not lay down any guidelines as to how the contributions already made by International Workers or on behalf of International Workers are to be dealt with.

We should, however, await a circular from the Central Provident Fund Commissioner, in regard to the above. In the event that no such circular is forthcoming, the establishments to which Paras 83 of the EPF Scheme and Para 43A of the EP Scheme were earlier applicable, would be advised to stop deduction of the contribution from such international workers and should desist from making over such contribution along with the Employer's contribution to the authorities in the State of Karnataka.

Considering the importance and the impact of the judgment, it is felt that the matter will go to Supreme Court for a final decision.

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Important date to remember

Particulars	Extended Date
Extension of Date for filing 10A/Form 10AB under Income-Tax Act to 30-06-2024 from 30-09-2023	30.06.2024

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