



India Tax Konnect

November 2024

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Direct Tax

a. Decisions – International Tax



Foreign tax credit available in India even if the legal position in source state differs: Mumbai Tribunal¹

Facts of the Case

The taxpayer, an Indian tax resident, provides legal services.

It received professional fees from clients in the foreign countries (including Japan). The taxes were withheld by these clients as per the respective tax treaties.

The taxpayer claimed foreign tax credit (FTC) in India for these tax withholdings.

The taxpayer had not filed its tax return in Japan.

The tax officer denied FTC for tax withheld in Japan, arguing that the taxpayer did not have a fixed base in Japan for more than 183 days as per the article dealing with the independent personal services, and thus no tax was liable to be withheld in Japan.

Revenue's Contentions

The taxpayer was not 'subjected to tax' in Japan as they had not filed a tax return there, and thus, the FTC should not be allowed.

The withholding tax does not amount to final payment of taxes and taxes withheld cannot be construed as taxes paid in the foreign jurisdiction without the filing of a tax return.

Taxpayer's Contentions

The fees earned in Japan were taxable in Japan as fees for technical services (FTS) under Article 12 of the India-Japan treaty and that FTC should be granted for the taxes withheld.

The FTC claim should not be denied based on the non-filing of a tax return in Japan, as the relevant treaty provisions do not require such filing for granting the FTC.

Decision

The Mumbai Bench of the Tribunal held that the taxpayer is entitled to FTC for the taxes withheld in Japan.

It relied on its earlier decision in the case of same taxpayer wherein it has been held that if the source jurisdiction has taken a reasonable and bona fide view (which is not manifestly erroneous) that taxes should be withheld, the resident jurisdiction should provide FTC, even if the legal position in the residence jurisdiction differs.

¹ ITA No. 852/M/2024. Source: Taxsutra

Direct Tax



b. Decisions – Domestic Tax

Broken period interest is allowable as deduction to the banks: Supreme Court²

Background

The scheduled banks in India are required to maintain statutory liquidity ratios (SLR) through the purchase of government securities in the following categories: (a) Held to Maturity (HTM); (b) Available for Sale (AFS); and (c) Held for Trading (HFT).

The interest on the securities is paid on specific fixed dates called coupon dates, say after an interval of six months. When a bank purchases a security on a date which falls between the two coupon dates, the purchaser bank, in addition to the price of the security, has to pay an amount equivalent to the interest accrued for the period from the last coupon date till the date of purchase. This interest is termed as the interest for the broken period.

The dispute arose whether the broken period interest paid can be claimed as a revenue expenditure or whether it needs to be capitalised and added to the cost of securities.

Facts of the case

The taxpayer, a scheduled bank, held HTM securities as stock-in-trade.

The taxpayer consistently followed the method of setting off the amount of broken period interest against the interest received by it on the sale of securities and offering the net interest income to tax.

² *Bank of Rajasthan Ltd v. CIT* (Civil Appeals No. 3291-3294 of 2009). Source: Taxsutra

Judicial precedents

In the case of *Vijaya Bank*³, the Supreme Court held that the outlay on the purchase of income-bearing asset was a capital outlay, and no part of the capital outlay can be set off an expenditure against income from that asset.

The decision in the case of *Vijaya Bank* was rendered in the context of provisions⁴ dealing with the head 'interest on securities' which were repealed by the Finance Act, 1988.

In the *American Express* decision⁵, the Bombay High Court held that the *Vijaya Bank* decision is not applicable after the repeal of those provisions.

Taxpayer's contentions

As the securities are held as stock-in-trade, the broken period interest should be deductible as a revenue expenditure.

As the taxpayer was a banking company which buys and sells the securities as part of regular business operations, the securities were held as stock-in-trade (though treated as investments in the books of accounts).⁶ The accounting treatment is not determinative of taxability under the Income-tax Act, 1961 ('the Act').

So long as the banks maintain a specified percentage of reserve, they are permitted to buy and sell the securities, irrespective of their categorisation. Further, the banks can shift the HTM securities to any other two categories.

³ *Vijaya Bank Ltd v. ACIT* [1991] 187 ITR 541 (SC)

⁴ Sections 18 to 21 of the Act

⁵ *American Express International Banking Corp v. CIT* [2002] 258 ITR 601 (Bom) (approved by the Supreme Court in *CIT v. Citi Bank NA* (Civil Appeal No. 1549 of 2006))

⁶ *CIT v. The Cocanada Radhaswami Bank Ltd* [1965] 57 ITR 306 (SC)

Direct Tax...

The taxpayer's method of accounting had been consistently accepted by tax authorities in the past and any deviation now would be inconsistent and unjust.

Reference was made to CBDT Circular 18 of 2015 which provides that income from such investment is taxable as business income. Reference was also made to RBI Circular of 2009 which provides that the broken period interest is not to be capitalised but debited to the profit and loss account.

Revenue's contentions

The broken period interest should be treated as capital expenditure since it pertains to the acquisition of capital assets (securities), which are not intended for immediate resale but are held to maturity. The securities are treated as investment in the books of accounts.

Circular No. 18 of 2015 applies only to non-SLR securities.

The increase in capital by the acquisition of securities results in the expansion of the Bank's capital base, which helps in profit making. Therefore, the expenditure in the nature of broken period interest was capital expenditure.

The principle laid down in the *Vijaya Bank* decision will continue to apply as there have been corresponding amendments in other sections of the Act.

Decision

The broken period interest is a deductible expense under the head 'profits and gains of business or profession', primarily because the securities are held as stock-in-trade and not as investments.

As per CBDT Circular No. 599, the securities held by the banks must be recorded as their stock-in-trade. However, the circular was withdrawn in view of the *Vijaya Bank* decision.

As per RBI Circulars dated 21 April 1998 and 21 April 2001, the banks should not capitalise broken period interest paid as a part of cost but treat it as an expenditure in their profit and loss account.

CBDT Circular No. 4 of 2007 observed that a taxpayer can have an investment portfolio comprising of capital assets and a trading portfolio comprising of stock-in-trade.

Even though some securities might be held until maturity, the general business practice and the nature of banking operations necessitate treating such expenditures as part of the business expenses.

Benefit of lower tax rate is available even if the manufacturing activities commence after the filing of tax return for the first year, but within the prescribed timeframe: Hyderabad Tribunal⁷

Facts of the case

The taxpayer was an Indian company set up on 16 January 2023.

It filed its tax return for the financial year ended 31 March 2023 along with Form 10-ID on October 21, 2023, claiming the benefit of lower tax rates.

⁷ *Granules CRZO Pvt Ltd v. ITO* (ITA No. 706/Hyd/2024). Source: Taxsutra

Direct Tax...

The lower tax rates are applicable⁸ if a taxpayer (a) is domestic company set-up and registered on or after 1 October 2019 (b) has commenced manufacturing or production of an article or thing on or before 31 March 2024.

The Revenue denied the claim of lower tax rates stating that the taxpayer had not commenced its production during the year under consideration (i.e., FY 2022-23).

Taxpayer's Contentions

It was precarious situation as the taxpayer was required to file its tax return for the period from 16 January 2023 to 31 March 2023 by October 2023, while the sunset date for commencing manufacturing is 31 March 2024.

Its manufacturing activities were set to begin by March 31, 2024, which was within the permissible time frame (though the activities commenced after filing the tax return for financial year 2022-23).

Decision

Form 10-ID is required to be filed along with the tax return for the first assessment year (which is AY 2023-24 in the instant case).

It was not possible to mention the date of commencement of manufacturing activities in Form 10-ID as the form was filed prior to that date.

Thus, even if the manufacturing activities has not commenced, the taxpayer was required to file the certificate showing the commencement of manufacturing activities. The taxpayer was prohibited to file Form 10-ID in the subsequent year when it has actually started the manufacturing activity.

In view of the above, so long as the taxpayer commenced manufacturing activities before March 31, 2024, this should be considered by the Revenue for the purpose of granting the benefit of lower tax rate.

Reserve recorded in the books of amalgamated company pursuant to merger of step-down subsidiary is capital in nature: Mumbai Tribunal⁹

Facts of the case

The taxpayer was an Indian company.

It held the entire share capital of an Indian company (Orval) which in turn held the entire share capital of another Indian companies – Celina Buildcon and Infra (Celina/ amalgamating company).

Celina merged with the taxpayer. In other words, the taxpayer's step-down subsidiary got merged into it.

Due to the restriction under the Companies Act, 2013¹⁰, no shares were issued by the taxpayer to shareholders of Celina (as the shareholders of Celina i.e., Orval was the taxpayer's subsidiary and the Companies Act, 2013 restricts issuing the shares to the subsidiary company).

⁸ Section 115BAB of the Act

⁹ *DCIT v. Samagra Wealthmax Pvt Ltd* (ITA No. 2165/Mum/2023)

¹⁰ Section 19 of the Companies Act, 2013 restricts issuing the shares to its subsidiary

Direct Tax...

The above transaction resulted in capital reserve in the books of the taxpayer.

The taxpayer argued that such reserve is capital in nature and thus, not taxable.

Revenue's contentions

The receipt of property without paying adequate consideration is taxable as 'income from sources.' The instant transaction is covered by that provision as the taxpayer received assets without paying any consideration.

Though there is an exclusion for the capital asset transferred by a wholly owned subsidiary to its holding company, but that exclusion is not applicable in the instant case as the transferee was not the wholly-owned subsidiary of the taxpayer (it was a step-down subsidiary).

Alternatively, the receipt of shares is a benefit or perquisite taxable as business income under section 28(iv) of the Act.

Taxpayer's contentions

The definition of amalgamation under the Act contains an exclusion for the amalgamated company to issue the shares where the shares of the amalgamating company are already held by the amalgamated company or its subsidiary.

As the shareholding of Celina (amalgamating company) is held by subsidiary of assessee company, the instant case is covered by that exception and the instant transaction qualifies as an amalgamation for the purposes of the Act.

Receipt of a capital asset pursuant to an amalgamation is not regarded as transfer

for the purposes of capital gains taxation and the same is also excluded from the purview of section 56(2)(x) of the Act.

Even otherwise, the assets acquired by the taxpayer are not covered within the meaning of term 'property' and thus, not covered by section 56(2)(x) of the Act.

The issuance of shares by the taxpayer to the shareholders of the amalgamating company would have resulted in violation of the provisions of Companies Act, 2013.

Though Orval wrote off its investment in the shares of Celina, it did not claim the diminution in the value of the investment as an expense at the time of filing of its return of income. Thus, no benefit has been claimed by Orval on the write-off of the investment.

Decision

The Mumbai Bench of Tribunal accepted the taxpayer's position and held that:

- The taxpayer was indirectly/ ultimately holding the shares of Celina which after amalgamation led to the direct ownership of the assets in the taxpayer's name. The taxpayer has neither become richer nor poorer. A book entry to record a reserve under the double entry system of accounting cannot give rise to a benefit or perquisite. Also, the reserve arising out of amalgamation cannot be said to be created on account of regular business activity.
- The amalgamation qualified under section 2(1B) of the Act and thus, the transaction is not regarded as transfer under section 47(vi) of the Act.
- The provisions of section 56(2)(x) did not apply given the specific exemptions provided for transactions not regarded as a transfer under section 47 of the Act.

Foreign Exchange Management Act

Operational framework for reclassification of Foreign Portfolio Investment to Foreign Direct Investment issued by the Reserve Bank of India

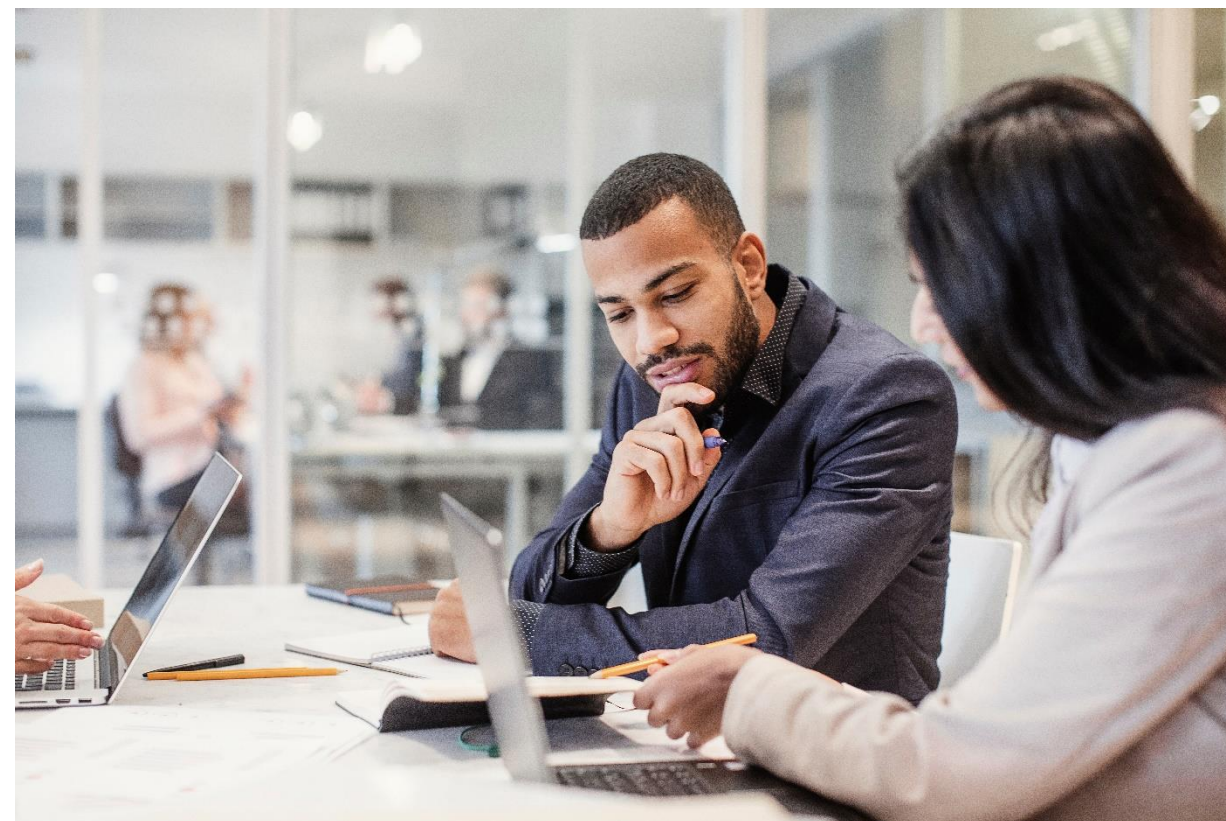
The Schedule II of The Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (**NDI Rules**) states that the total investment made by Foreign Portfolio Investors (**FPIs**) and their investor groups in an Indian listed company should be less than 10 percent of the total paid-up equity capital on a fully diluted basis. In the event of a breach of this limit, the FPI has the option to either divest its holdings or reclassify them as Foreign Direct Investment (**FDI**).

In this regard, the Reserve Bank of India (**RBI**) introduced an operational framework for the reclassification of FPI to FDI vide A.P. (DIR Series) Circular No. 19 issued on 11 November 2024.

The Reserve Bank of India designates 10-year Sovereign Green Bonds under Fully Accessible Route for investment by non-residents

The Reserve Bank of India (**RBI**) has expanded the list of specified Government securities that non-residents can invest in under the Fully Accessible Route (FAR) by including 10-year Sovereign Green Bonds (**SGBs**).

The RBI has designated SGBs of 10-year tenor issued by the Government of India in the second half of the fiscal year 2024-25 as 'specified securities' under the FAR vide RBI Circular (FMRD.FMD.No.06/14.01.006/2024-25) dated 7 November 2024



Indirect Tax

Instructions



Guidelines for conduct of personal hearings under Indirect Tax laws¹¹

The Central Board of Indirect Taxes and Customs had issued an instruction dated 21 August 2020 which made it mandatory for the adjudicating, appellate and compounding authorities to conduct personal hearing through video conferencing facility.

Such instruction was amended by another instruction issued on 28 July 2022 wherein it was mentioned that personal hearing would be conducted virtually only at assessee's request. The virtual mode of hearing will not be mandatory.

However, on the basis of representations received, the amendment made through instruction dated 28 July 2022 has been withdrawn. Accordingly, it is now mandatory for the authorities to conduct personal hearings through virtual mode. On written request from the concerned party, physical hearing may be allowed on exceptional basis.

¹¹ Instruction F. No. 390/Misc/3/2019-JC dated 5 November 2024

High Court/Tribunal decisions



Business Transfer Agreement (BTA) cannot be vivisected to tax non-compete clause separately¹²

The Appellants entered into a BTA for the sale of a business as a whole, including major conditions like Performance Guarantee for two years, Non-Compete and Non-Solicitation Restrictions, etc. 'Service by way of transfer of a going concern' was fully exempted from service tax as per mega exemption Notification No. 25/2012-Service tax dated 20 June 2012.

The Department issued a Show Cause Notice ('SCN') stating that the activities of agreeing to obligations/refraining from certain activities for two years should be treated as a Declared service under section 66(E)(e) of the Finance Act, 1994. Subsequently, confirmed the demand of service tax along with penalty. Aggrieved by the order, the present appeal was filed.

The appellant contended that the value offered for any concern is towards the market value and not for the indemnity clause. The terms of indemnification are routine conditions for transferring any running business concern. Further, no separate services are intended to be received, and no consideration is assigned for the indemnity clause so that service tax can be demanded.

¹² *Sicon Design Technologies Pvt. Ltd* [2024 (2) TMI 964] CESTAT Bangalore

Indirect Tax

The Department contended that non-compete and non-solicit contained in the agreement would get covered under Declared Services, since it was an obligation to refrain from an act, or to do an act. The value for the asset in the transaction is negligible and the entire amount involved is towards the non-compete clause, which is the essence of the contract.

The Bangalore Tribunal noted that the contract was for sale of business and it is natural to have a non-compete clause in such contracts. No consideration was identified for the non-compete clause nor was there any finding by the original adjudicating authority to the effect that substantial part of the consideration pertained to such indemnity.

The Tribunal referred to the Supreme Court judgment in *Ishikawajma Harima Heavy Industries*¹³, emphasizing that contracts must be construed as a whole, keeping in view the parties' intentions. Circular No. 178/10/2022 dated 03 August 2022, under GST was also referred to which clarified that payments for non-compete clauses do not constitute 'consideration' for taxable services unless made for an independent activity of tolerating an act. The Tribunal concluded that the non-compete clause is a standard part of business transfer agreements and does not constitute a separate service liable to service tax. Consequently, the interest and penalties imposed were also set aside.

¹³ 2007 (6) S.T.R. 3 (S.C.)

Refund to a GST registration cannot be denied if payment received in bank account of another registration (under the same PAN)¹⁴

Petitioner had its registered office in Karnataka and branch offices in Delhi and Maharashtra. Petitioner was providing Business Support Services ('BSS') to Vodafone Group outside India from its branch office in Delhi treating it as 'export of services' under section 2(6) of the IGST Act, 2017. The payments for the services were received in the bank account linked to the Karnataka office. Petitioner claimed a refund of unutilized ITC for Delhi registration which was rejected by the adjudicating authority and later by the appellate authority.

The Department contended that clause (iv) of section 2(6) of the IGST Act, 2017 requires payment to be received by the 'supplier of service' in forex. In the instant case, the services were provided by the Delhi office but the payments were received by the Bangalore office. In terms of sections 25(4) and 25(5) of the CGST Act, 2017 once a registration is obtained in a state or union territory for an establishment, such establishments are to be treated as establishments of distinct persons. This is a departure from the general principle of a branch or establishment not being viewed as a separate juridical entity. Accordingly, in this case, the payment is not received by the supplier of service i.e. Delhi office and thus, refund is liable to be rejected.

The Delhi High Court observed that the IGST Act while defining the expression 'export of service' in section 2(6) lays emphasis on the payment for such service being received by the 'supplier of service'. Clause (iv) of section 2(6) of the IGST Act 2017 does not tie the receipt of payment to a particular bank account.

¹⁴ *Cable and Wireless Global India Private Limited* [(2024) 23 Centax 161 (Del.)]

Indirect Tax

In terms of the definition of 'location of supplier of services' under section 2(15) of the IGST Act, 2017, *inter alia*, where a supply is made from a place of business for which registration is obtained, the location of such place of business is to be considered as the location of supplier of services. In this case, as the services are provided from Delhi office, the location of the supplier of service is Delhi. Merely because the remittance is received in a bank account in Karnataka, the same would not alter or impact the determination of the actual supplier of service.

Accordingly, the Court quashed the order.

Validity of advance receipt voucher to avail ITC under the GST law¹⁵

The petitioner, L & T IHI Consortium (constituted by Larsen & Toubro Ltd. and IHI Infrastructure Systems Co. Ltd., Japan), was awarded a contract by the MMRDA for the construction of the Mumbai Trans Harbour Link Project. The contract involved advance payments, in the form of interest-free loans, made by MMRDA to the petitioner. Such amounts were to be adjusted through percentage deduction from the interim payment to be made to the contractor. The petitioner, in turn, remitted advance payments and GST thereon, to its constituent.

The petitioner was precluded from availing ITC on the GST collected by the constituent on the advance payments on the ground that the actual supply of goods or services had not been received, and that receipt voucher was not a valid document for availment of ITC. The petitioner filed a refund application on the ground that the advances received were loans and GST paid was wrongly paid. However, such refund was rejected by tax authorities.

The petitioner contended that provisions of section 7 of the CGST Act, 2017, which includes 'supplies agreed to be made' within the scope of supply, are ultra vires the Constitution. The advance payments should not attract GST as they were loans and not consideration for supply. The constitutional validity of sections 12, 13, and 16(2)(b) of the CGST Act, 2017 was challenged, claiming that ITC was unjustly denied. They were entitled to ITC but were denied due to the non-receipt of goods or services at the time of payment and that authorities did not accept receipt voucher as a valid document under section 16(2)(a) of CGST Act, 2017 read with rule 36 of the CGST Rules, 2017.

The Government on the other hand contended that the advance payments were part of the mobilization advance and not loans, thus subject to GST under the CGST Act. The petitioner was not entitled to input tax credit as the services had not been received and no tax invoice was issued. The provisions of the CGST Act were constitutionally valid and that the petitioner had not exhausted all available remedies.

The Bombay High Court held that the provisions of sections 7, 12, 13, and 16(2)(b) of the CGST Act, 2017 were constitutionally valid. The advance payments fell within the scope of 'supply' under the CGST Act, 2017 and were subject to GST.

In respect of the petitioner's argument regarding section 16(2)(b) of the CGST Act, 2017, the High Court observed that the words 'intended to be used in the course or furtherance of his business' used in section 16(1) of the CGST Act, 2017 would include the deferred receipt of goods or services or both. Also, the word 'intended' as used in section 16(1) of the CGST Act, 2017 is required to be given its due meaning in applying the provisions of sub-section (2)(b) of section 16, when it prescribes that the credit of any input tax would *inter alia* be available when the registered person has '**received**' the goods or services or both. If we do not attribute such meaning in conjointly reading the provisions of sub-section (1) and sub-section (2)(b) of section 16, it is likely to create an anomalous situation which is never the intention of legislature.

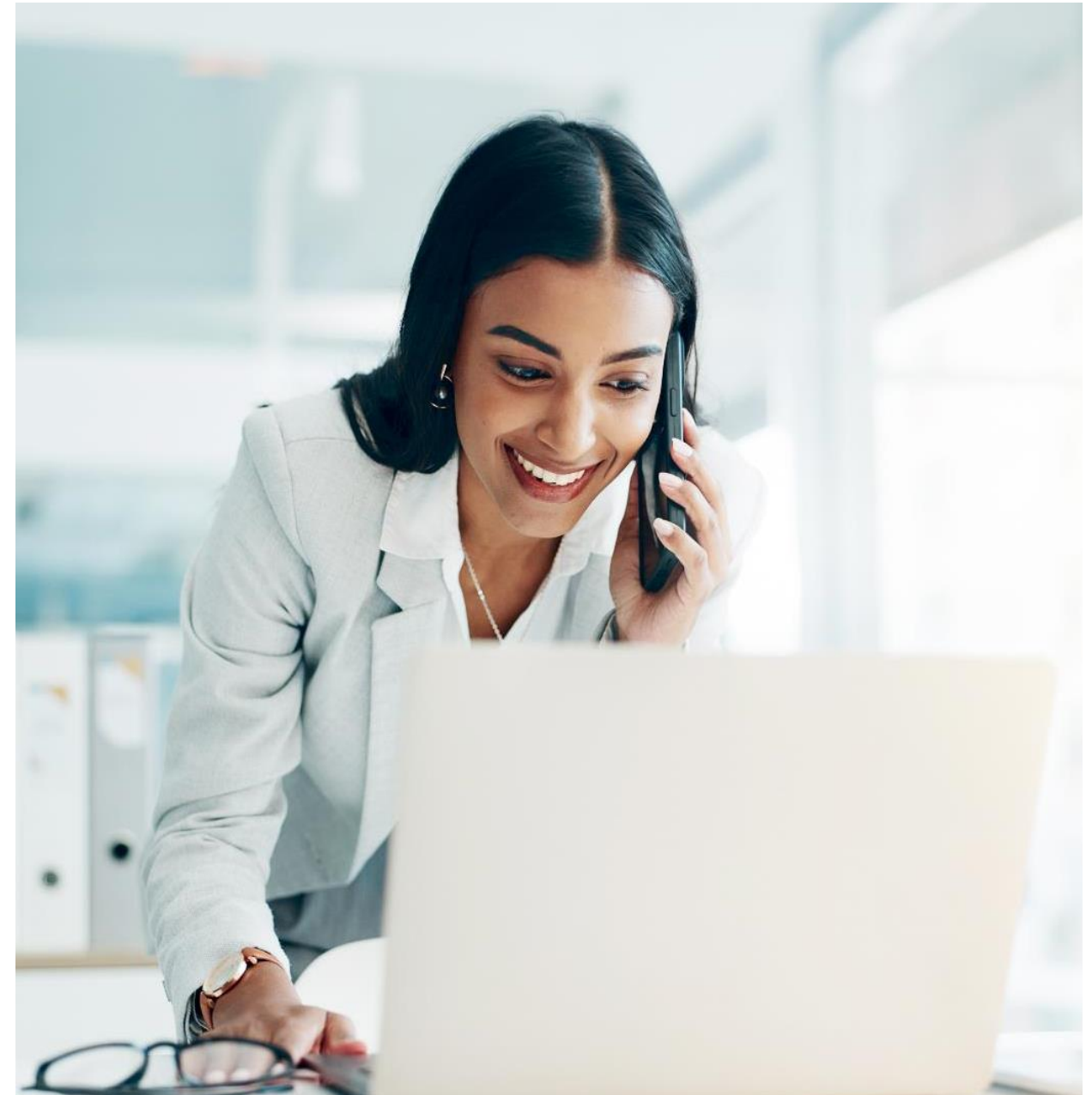
¹⁵ L & T IHI Consortium.[2024-VI L-1219-BOM]

Indirect Tax

Regarding the argument about rule 36 of the CGST Rules, 2017, the Court held that the rigor and the mandate of sub-section (1) and (2) of section 31 is not applicable to the operation of sub-section (3) which stands on its independent legs, when it recognizes the tax paying documents as referred thereunder. Sub-section (3) of section 31 is also required to be read in the context of the other sub-sections of section 31 which contemplate a variety of situations, where an invoice can be issued even when at a belated stage. Thus, section 31 is required to be holistically read.

The court therefore held that when the petitioner satisfied the requirements of section 31(3)(d), he is denied input tax credit, merely because he has not complied with the part of the provisions, namely sub-section (2) of section 31 read with rule 36. In any event, rule 36 cannot control the operation of section 31 being the substantive statutory provision.

Accordingly, the court held that the petitioner was entitled to the benefit of input tax credit.



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