India Tax Konnect

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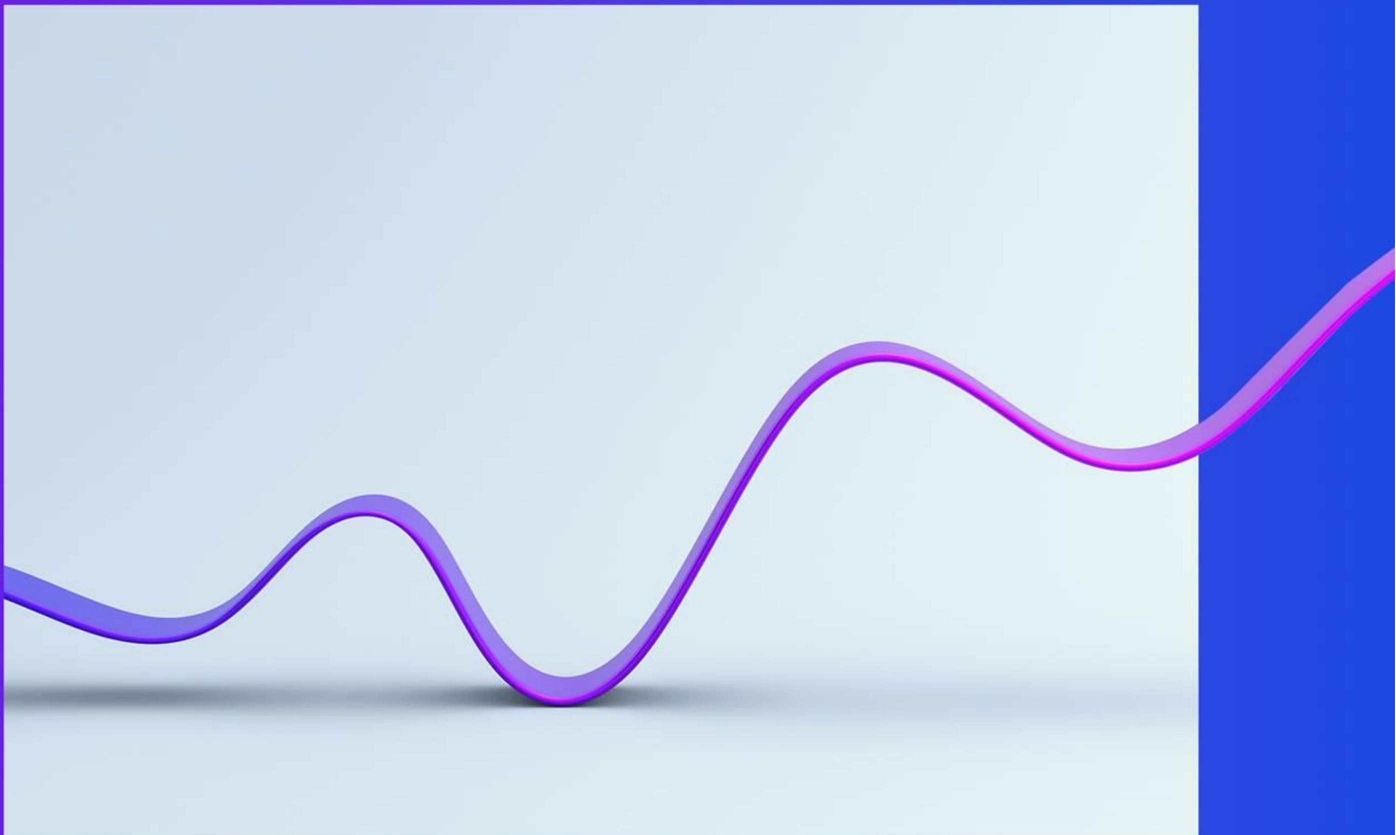

Contents

1	**Direct Tax**	**4**
1.1	**Decision - International Tax**	**4**
1.2	**Decisions - Domestic Tax**	**4**
2	**Foreign Exchange Management Act, 1999**	**9**
3	**Indirect Tax**	**11**
3.1	**High Court Decisions**	**11**

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Direct Tax

1 Direct Tax

1.1 Decision - International Tax

Management/processing fees relating to the loan are covered under the term 'interest' and exempt under Article 11 of the India-Germany tax treaty in view of a specific provision: Delhi Tribunal[1]

The taxpayer (a German company) was engaged in the banking business. The taxpayer had given an external commercial borrowing loan to an Indian company. The loan was protected by HERMES-Deckung which was acting jointly for, and on behalf of, the Federal Republic of Germany. In relation to the loan, the Indian company, in addition to the interest, paid commitment fees, management/ processing fees, and documentation fees to the taxpayer. The taxpayer claimed that the interest and the fees were exempt under Article 11(3)(b) of the India-Germany tax treaty (the treaty) as the loan was guaranteed by HERMES-Deckung.

The tax officer agreed with the taxpayer's claim that the interest, commitment and documentation fees were exempt under the treaty. However, it was held that the management/processing fees were not covered by the term 'interest' under Article 11 of the treaty and were taxable as fees for technical services (FTS).

The Delhi bench of the Tribunal referred to the definition of 'interest' under the treaty and under section 2(28A) of the Income-tax Act, 1961 (the Act) and observed that the term 'interest' includes any service fee or other charge in respect of the money borrowed or debt incurred.

The Tribunal held that the management fees were similar to the commitment and documentation fees, as it was closely linked to the loan granted. It partakes the character of interest under section 2(28A) of the Act. Hence, such fees were exempt in terms of Article 11(3)(b) of the treaty.

1.2 Decisions - Domestic Tax

Sales tax subsidy received to incentivise the setting up of new units and expanding the existing units in underdeveloped and developing areas is a capital receipt: Delhi High Court[2]

The Government of Maharashtra notified the scheme of 'Dispersal of Industries Package of Incentives, 1993' (the Scheme) which intended to achieve the dispersal of industries outside the Mumbai-Thane-Pune belt and to incentivise the setting up of new and expanding the existing units in underdeveloped and developing areas. To take benefits of the Scheme, the taxpayer set up industrial units in Nagpur. The taxpayer received the sales tax subsidy under the scheme and treated the subsidy as a capital receipt, not chargeable to tax.

The Revenue argued that the subsidy received by the taxpayer was revenue in nature on the following grounds:

- The mere factum of setting up a new unit in a particular geographical region would not be sufficient to treat the sales tax incentive as a capital receipt.
- The Scheme was a production-linked incentive scheme that kicked in only after the eligible unit had commenced production.
- It was not for setting up the industrial unit but to make the industrial units viable by increasing their working capital. It improved liquidity by providing sales tax incentives.
- The Scheme was not intended to contribute towards the capital outlay of the industrial unit.

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[1] *Aka Ausfuhrrkreditgesellschaft Mbh* v. *ACIT* (ITA No.783/DEL/2023) (Del)

[2] *CIT* v. *Indo Rama Textiles Ltd* (ITA 392/2014) (Del)

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The Delhi High Court held that the sales tax subsidy received by the taxpayer was a capital receipt. The High Court referred to the 'purpose test' laid down by the Supreme Court in the *Sahney Steel* case[3] and observed as follows:

- The manner of quantification of the subsidy/incentive (whether it is linked to turnover or the cost of a capital asset) would not be a determinative factor in concluding the character of the subsidy. The purpose and the object with which the subsidy/incentive was extended would determine its character - whether the subsidy is given to set up an industry or to operate the industrial unit profitably.
- The purpose of the Scheme was to industrialise the underdeveloped and developing areas by incentivising the setting up of new and expanding the existing units.
- Various incentives provided under the Scheme were for setting up a new unit or large-scale investment in fixed capital.
- The eligibility certificates were issued for setting up a 'new unit' and for a 'pioneer unit' which had undertaken expansion.
- The argument of the Revenue that the subsidy was granted to assist in carrying on business operations and thereby make the industries more profitable was not acceptable.

Weighted deduction on scientific research is not to be restricted to expenditure incurred after the date of grant of approval of R&D facility: Delhi High Court[4]

Section 35(2AB) of the Act provides a weighted deduction of 150 per cent to the eligible companies for any expenditure on scientific research on an in-house research & development (R&D) facility approved by the Secretary, Department of Scientific & Industrial Research (DSIR).

The taxpayer (an Indian company) was engaged in the business of developing software products. The taxpayer filed an application with the DSIR for approval of its R&D facility to claim the benefit under section 35(2AB).

The R&D facility received recognition for the period beginning on 27 February 2019 to 31 March 2021. Subsequently, the R&D facility got approval under section 35(2AB).

The taxpayer had incurred expenditure for the creation of the R&D facility prior to 27 February 2019. Relying on the DSIR guidelines[5], the taxpayer argued that the approval was to be given from 1 April of the year in which the application for the approval was filed. In the instant case, the application was filed during the financial year 2018-19, thus the approval should have been given from 1 April 2018 and the weighted deduction should be allowable for expenditure incurred since 1 April 2018.

The DSIR argued that the grant of approval is a *sine qua non* for claiming the deduction under section 35(2AB). Thus, the deduction cannot be claimed for a period when the R&D facility was not recognised or approved. The approval is to be considered a co-terminus with the DSIR recognition.

The Delhi High Court, agreeing with the decision of the Gujarat High Court in *Claris Lifesciences Ltd*[6]*,* held that the weighted deduction is allowable only for expenditure incurred after the date of grant of approval is untenable. The High Court observed that:

The Finance Act, 2015 introduced sub-clause (xviii) to section 2(24) w.e.f 1 April 2016 to amend the definition of 'income' to include assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver, etc. by the Central Government or a State Government or any authority or body or agency in cash or kind. Years under consideration in this case were assessment years 1997-98, 2005-06, 2008-09, 2013-14, and 2014-15 and the amendment was not applicable in this case

[3] *Sahney Steel & Press Works Ltd* v. *CIT* [1997] 228 ITR 253 (SC)

[4] *Nagravision India Private Limited* v. *Secretary, Department of Scientific and Industrial Research* (WP (C) 5666/2020) (Del)

[5] *Guidelines for approval in Form 3CM of in-house R&D centres recognised by DSIR and submission of the report in Form 3CL under section 35(2AB)*

[6] *CIT* v. *Claris Lifesciences Ltd* [2010] 326 ITR 251 (Guj)

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- Section 35(2AB) is a beneficial provision with an object to give an impetus to scientific research and the creation of robust R&D infrastructure.
- While the approval of the R&D facility is a pre-condition for further consideration of a claim, the expenditure incurred in the creation of such a facility was not restricted to a date anterior to the grant of approval. Section 35(2AB) does not link the expenditure with the approval by the DSIR.
- Section 35(2AB) and Rule 6 of the Income-tax Rules, 1962 (the Rules) contemplates R&D facilities that have been duly created and expenditure having been incurred before approval or recognition was granted by the prescribed authority.
- If the facility did not exist, there would be no occasion for the DSIR to either inspect the same or enter into a collaborative arrangement.

Capital reduction is distinct from the buy-back of shares and therefore not covered by buy-back tax provisions as existed prior to 1 June 2016: Mumbai Tribunal[7]

Prior to 1 June 2016, section 115QA of the Act provides for taxation of the distributed income on account of the buy-back of unlisted shares of a company undertaken in accordance with the provision of section 77A of the Companies Act, 1956 (Co Act). The Finance Act, 2016, with effect from 1 June 2016, amended section 115QA to cover any transaction of buy-back of unlisted shares undertaken by the company in accordance with the provisions of any law for the time being in force relating to companies (and not necessarily restricted to section 77A).

The taxpayer (an Indian company), under the scheme of capital reduction in accordance with the provisions of sections 100 to 104 of the Co Act reduced the share capital by canceling equity shares of the company. The scheme was approved by the High Court on 16 April 2016.

The tax officer held that the premium amount paid to shareholders was liable to tax under the buy-back tax provision of section 115QA on the following grounds:

- The taxpayer bought back the shares at a huge premium under the guise of share capital reduction with the intention to make unjust enrichment of shareholders and also to avoid the payment of dividend distribution tax.
- Buy-back taxation is not necessarily restricted to Section 77A, but it applies when the companies distribute their income in response to shares being brought back under any other provision.
- The distinction in section 77A and sections 100 to 104 of the Co Act was not in accordance with the law.
- Once the object and the purpose of the legislator is known, it is the duty of the court to give a purposeful or functional interpretation to the statute.

The taxpayer argued that till 1 June 2016, in case of reduction of share capital in accordance with sections 100 to 104 of the Co Act, there was no tax incidence in the hands of the company, but it was taxable in the hands of the shareholder under Section 2(22)(d) of the Act. Thus, section 115QA did not apply to the taxpayer's case.

The Mumbai bench of the Tribunal held that the transaction of the capital reduction cannot be covered under buy-back tax provisions of section 115QA as existed prior to the amendment. The Tribunal observed that:

- Prior to 1 June 2016, section 115QA is applicable only if the company purchases its own shares in accordance with the provisions of section 77A.
- In the present case, the taxpayer had not carried out the buy-back under section 77A. However, it was a transaction of capital reduction under section 100-104 of the Co Act.

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[7] *ACIT* v. *Meriton Infotech Pvt Ltd* (ITA No. 741/Mum/2023) (Mum)

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- In the instant case, all the conditions of the reduction of share capital were concluded on 31 May 2016.
- Thus, such capital reduction was not covered within the definition of buy-back under section 115QA and the taxpayer was not liable to tax on the distributed income.

In the case of a transfer of a capital asset by a partner to a firm as a capital contribution, section 45(3) being a specific provision, will prevail over the general provisions of section 50C: Ahmedabad Tribunal[8]

Section 45(3) of the Act provides that when a capital asset is transferred to a firm by a partner as a capital contribution, then the amount at which, the firm records such capital assets in its books, shall be deemed as full of value of consideration (FVC) for the purpose of computation of capital gains.

Section 50C of the Act provides that in case of consideration for a transfer of a capital asset, being land or building or both, is less than the value assessed by the state government for the stamp duty, then such assessed value shall be treated as the FVC for the capital gains tax computation.

The taxpayer, an individual, transferred an immovable property to a partnership firm as a capital contribution.

The tax officer invoked the provisions of section 50C and took the stamp duty value of the property as an FVC for the purpose of computation of capital gain on the ground that section 50C is a special provision with respect to capital assets, being land or building.

The taxpayer argued that the value of capital asset contribution to a partnership firm should be determined as per the provision of section 45(3) and not as per section 50C. There is no consideration received or receivable by him on capital contribution in the firm in the form of land. Hence, there was no assessable value of land for charging stamp duty in connection with such transfer. Therefore, the provision of section 50C cannot be made applicable.

The Ahmedabad bench of the Tribunal, following the Delhi special bench of the Tribunal in the case of *DLF Universal Ltd*[9] held that the stamp duty value provisions under section 50C are not applicable to determine FVC in case of the transfer of a capital asset by a partner to a firm as a capital contribution. The transaction will be governed by the provisions of section 45(3) and FVC is to be taken as book value recorded by the firm. The Tribunal observed that:

- Section 50C is a general provision in the given facts and circumstances whereas section 45(3) is a specific provision dealing with the transfer of capital assets by the partner to the partnership firm by way of capital contribution.
- Relying on the Supreme Court's case in *State of Rajasthan v. Gopi Kishan Sen*[10], it was observed that when two conflicting provisions of law operate in the same field, the provision that specifically operates in that field would apply over the general rule.
- The Tribunal distinguished the Allahabad High Court's decision in Carlton Hotel (P.) Ltd.[11] based on the facts of the case. In that case, the Revenue argued that the transaction was a sham transaction designed to evade taxes.

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[8] *Nareshbhai Ishwardas Patel* v. *ITO* [2023] 203 ITD 250 (Ahd)

Note: The Tribunal also dealt with the issue of disallowance of claim of cost of improvement. However, this portion only covers the issue of the applicability of section 45(3) v. section 50C

[9] *DLF Universal Ltd. v. DCIT [2010] 3 ITR(T) 635 (Del)*

[10] *State of Rajasthan* v. *Gopi Kishan Sen* (AIR 1992 SC 1754)

[11] *CIT* v. *Carlton Hotel (P.) Ltd.* [2017] 399 ITR 611 (All)

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Foreign Exchange Management Act, 1999

2 Foreign Exchange Management Act, 1999

Central government allows direct listing of securities by public Indian companies on International Exchanges of GIFT International Financial Services Centre

Pursuant to the announcement on 28 July 2023 by the Union Minister for Finance and Corporate Affairs to enable direct listing of Indian Companies at GIFT- International Financial Services Centre (IFSC) exchanges in the first phase, the Department of Economic Affairs (DEA), Ministry of Finance, has amended Foreign Exchange Management (Non-debt Instruments) Rules, 2019, and notified the 'Direct Listing of Equity Shares of Companies Incorporated in India on International Exchanges Scheme'.

Simultaneously, the Ministry of Corporate Affairs (MCA) has issued Companies (Listing of Equity Shares in Permissible Jurisdictions) Rules, 2024.

These regulatory changes aim to provide an overarching regulatory framework to enable public Indian companies to issue and list their shares in permitted international exchanges. As of now, the framework allows unlisted public Indian companies to list their shares on an international exchange in the stipulated manner.

SEBI is in the process of issuing the operational guidelines for listed public Indian companies. The international stock exchanges at GIFT-IFSC under the regulatory supervision of IFSCA namely, India International Exchange and NSE International Exchange have been, currently, prescribed as permitted stock exchanges under the Rules and the Scheme.

Earlier, through the Companies (Amendment) Act, 2020, enabling provisions were included in the Companies Act, 2013, to allow the direct listing of prescribed class (es) of securities of prescribed class (es) of public companies incorporated in India on permitted stock exchanges in permissible foreign jurisdictions or other prescribed jurisdictions. The enabling provisions of the Companies (Amendment) Act, 2020 were, accordingly, brought into force with effect from 30 October 2023.

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Indirect Tax

3 Indirect Tax

3.1 High Court Decisions

Transferring the development rights does not tantamount to the sale of land and is therefore exigible to GST[12]

The Petitioner is in the business of conceptualizing, planning, constructing and developing commercial real estate projects. It entered into a Joint Development Agreement (JDA) with landowners for constructing towers. The Petitioner is of the view that by execution of JDA, there is the substantive transfer of development rights by the landowners in its favour. This results in the sale of land which is not exigible to GST in terms of Schedule III to the GST Act.

The Telangana High Court perused relevant clauses of the JDA and dismissed the writ petition. It held that the transfer of development rights is a service and not an outright sale of an immovable property. Other important inferences of this judgement are as follows:

- There are two sets of transactions. First is an agreement between the landowner and the Petitioner. Second is the supply of construction services by the Petitioner to the landowners. Pursuant to the second transaction, there is a sale of the constructed area to third-party buyers.
- Ownership is transferred from the landowner directly to the purchaser of the constructed property and not in favour of the Petitioner unless and until the land stands transferred in the name of the Petitioner.

Interest will not arise for the delay in filing Form GSTR-3B if the GST amount is deposited before the due date[13]

The Petitioner is a manufacturer of motorcycles. It had an accumulated balance of CENVAT credit. It filed Form GST TRAN-1 on 16 October 2017. However, the entire transitional amount did not get reflected in the Electronic Credit Ledger. Due to this, the Petitioner could not file the monthly return in Form GSTR-3B for the months of July to December 2017 within the due dates. Although the Petitioner was restrained from filing the monthly returns for the impugned period, it deposited the monthly GST liability in the Electronic Cash ledger under appropriate heads through Form GST PMT 06 challan within the prescribed due dates for each month. The Petitioner filed a revised Form GST TRAN-1 on 27 December 2017. On such filing, the entire transitional credit got reflected in the Electronic Credit Ledger. This enabled the Petitioner to file the monthly returns for the impugned period on 24 January 2018.

The Department sent a recovery notice dated 16 May 2023 demanding payment of interest for the alleged belated payment of GST for the period July to December 2017 and subsequently passed an order confirming the demand. The Petitioner challenged the recovery notice by way of a writ.

The Madras High Court held that the tax liability of a registered person will be considered to be discharged once the amount is paid to the credit of the Government by generating Form GST PMT 06. It further held that payment of interest will not arise in the given case since GST has already been credited to the Government before the due dates. It allowed the writ in favour of the Petitioner and quashed the order for recovery.

GST Authorities to serve notice through other modes if it does not receive a response to the notice sent over email[14]

The Adjudicating Authority served a notice over the common portal to the Petitioner. The Adjudicating Authority subsequently issued an order directing the Petitioner to pay the disputed

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[12] Prahitha Construction Private Limited v. Union of India & 3 Ors [2024-VIL-152-TEL]

[13] Eicher Motors Limited v. The Superintendent of GST and Central Excise & Anr [(2024) 14 Centax 323 (Mad)

[14] Sakthi Steel Trading v. Assistant Commissioner (ST) [(2024) 15 Centax 276 (Mad)]

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input tax credit along with the penalty. The Petitioner challenged this order on the grounds that it was not aware that the Adjudication Authority had sent a notice on the common portal.

The Madras High Court quashed the impugned order. It held that section 169 of the GST Act dealing with service of notice is a progressive provision intended to integrate technology with the assessment proceedings. It is a step to modernize the tax administration. However, the business community may be technologically challenged. As a matter of prudence, if notice is sent to a designated/registered email and is not responded to by the assessee, it is incumbent on the part of the Department to serve at least another notice through any of the other modes of service of notice as prescribed under section 169 of the GST Act.

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