TAXATION TIMES

December 2020

Taxation Times is a monthly newsletter published by UJA specifically with an intent and object to simplify and provide clarity on certain provisions of the Income Tax Act, discuss the implications of various amendments and circulars notified time and again, understand the judicial precedents as decided by various courts and interpret these.

The Taxation Times is an initiative to keep you abreast with the latest development in the realm of the Direct Taxes in India.

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We're almost to the close 2020 and it's been a roller coaster year for almost everybody. The whole world at large a witnessed a paradigm shift in work cultures. Remote working is becoming increasingly popular with more & more companies willing to adopt this working culture. Businesses are becoming more flexible and seem to be investing more in automation. E-commerce was booming prior to COVID – 19, however with people now forced to stay indoors due to the prevailing health crises, e-commerce has hit another peak. It would be interesting to see what other changes or after effects once the world at large starts resuming work as normal.

Coming back to this months Taxation Times, let's see what's in store this month –

1. DDT was withdrawn by the Budget 2020. Is this move by the Government beneficial? Who gains & who looses? More insights in the article inside.

2. Recent Judicial Precedents.

3. A Did You Know Series to state the news running around Direct Taxes.

4. Upcoming compliances for December 2020.

We hope that you find this edition of the Taxation Times useful.

Do you have any inputs to make the forthcoming issues of the Taxation Times more useful & relevant? Please share your feedback on info@uja.in.

We look forward to hearing from you!

Best Regards,
UJA Tax Team

DDT Gone! Impact : Good or Bad? Let’s Wait & Watch

Dividend forms a major source of income for shareholders of a company. The taxability of dividend has undergone major changes over the years. Companies would pay Dividend Distribution Tax (DDT) on dividend to be declared by them. The effective rate of DDT was 20.56%. The concept was introduced in 1997 and the motive of introduction was to collect taxes on dividend at a single point. Under such regime, dividend earned was exempt in hands of shareholders.

Finance Minister Hon’ble Smt. Nirmala Sitharaman abolished DDT in the Budget 2020, thus taxing dividend in the hands of the shareholders as previously prevalent. Thus, effective 1st April 2020 (AY 2021 – 2022), no DDT shall be payable by the companies & the shareholders shall pay taxes on the dividend so received.

Hon’ble Finance Minister in her Budget Speech stated that the abolition of DDT shall lead to an annual revenue loss of approx. INR 25,000 crore. However, since companies & individuals will now pay taxes on dividend earned at their applicable slab rates – it shall compensate for the loss of revenue due to abolition of DDT.

How would the abolition of dividend impact the different type of shareholders?

A. Resident Shareholders

Type of Shareholder	Effective Tax Rate	Impact
Individual & HUF	Dividend earned by resident shareholders will now be taxed at the applicable slab rates. For individuals & HUF earning income exceeding INR 1 crore, the effective slab rate shall be 35.88% (including surcharge & cess).	Since, the effective rate of DDT was 20.56%, the removal of DDT will be beneficial to those individuals/ HUF who are exempt from paying taxes/ lower tax slab. However, for individuals and HUF falling in the highest slab rate, the effective outflow of taxes will be higher.
Partnership & Limited Liability Partnership (‘LLP’)	Partnership’s & LLP’s will pay taxes at 31.20% on dividend received. However, if the total income of the partnership/LLP’s exceed INR 1 crore, effective tax rate shall be 34.94% (including surcharge & cess).	Due to the removal of DDT, partnerships and LLP’s pay taxes at their applicable slab rate. Therefore, this has resulted in an additional burden of outflow of taxes.

Domestic Companies	India has introduced new sections 115BAA & 115BAB in the Income Tax Act 1961. Companies can opt for the concessional tax rates subject to the conditions mentioned therein. Accordingly, dividends shall also be taxed in the hands of the companies at the effective tax rate:	For companies opting for s. 115BAB of the Income Tax Act 1961, companies pay a lower amount as against DDT. However, for other categories of companies, the abolition of DDT results in an additional outflow of taxes.

Type of Company	Effective Tax on Dividend*
Companies opting for s. 115BAB / 115BAA of the Income Tax Act 1961	17.16% / 25.17%
Companies opting for s. 115BA of the Income Tax Act 1961	29.12%
Companies opting for s. 115BA of the Income Tax Act 1961	29.12%
Other Companies	34.94%
*The aforesaid tax rates are inclusive of surcharge & cess.	

B. Non - Resident Shareholders

Incase of dividend paid to non – resident shareholders, taxes to be deducted at the rate 0f 20%. However, if India has a Double Taxation Avoidance Agreement (DTAA) with any country, the beneficial tax rate (i.e as per the Income Tax Act 1961 or DTAA) shall be made applicable to the shareholder. Further, here we may even bring attention to the fact that organizations may take the benefit of the Most Favored Nation (‘MFN’) clause if the treaty so allows.

Also, in this case what is to imperative to note that the taxes so withheld on dividend payout can be claimed as credit in the return of income of the non – resident shareholder. However, incase the dividend is tax exempt in the country of residence of the non – resident shareholder, the taxes so deducted on withholding taxes may become a tax cost.

Conclusion:

Though, the government has abolished DDT and reduced the compliance burden of the companies i.e non – deduction of DDT, it has mandated withholding of taxes to be deducted & paid on dividend pay outs to resident shareholders. TDS is to be withheld at 10%, however, if a taxpayer fails to furnish his Permanent Account Number (PAN), TDS to be deducted at a higher rate of 20%.

The removal of DDT puts an end to the regime where dividend received was exempt in hands of resident shareholders. The withdrawal of this tax will not hugely impact the revenue of the Government since, the taxpayers will now being pay taxes on the dividend received at their applicable slab rate.

The withdrawal of DDT is a step towards making investment in India more lucrative and can boost foreign investment in India.

Who stands to gain & who stands to loose from this major reform depends upon the effective tax rate of every shareholder. The overall impact of this amendment would be visible only in the long run and whether the revenue has actually gained or lost due to the withdrawal of DDT can be ascertained with time.

Recent Case Laws

"Recently the ITAT Bangalore ruled that, where the assessee was developing a new software platform which was discontinued and abandoned in the subsequent year and was never put to use, expenses in relation to the same cannot be treated as capital in nature."

Case Walkthrough:

The assessee[1] is engaged in business of online advertisement. During the assessment year (AY) under consideration, the assessee was in the process of developing a new software platform which can be used from desktop. The assessee incurred various expenditure including salary and marketing expenses for conducting feasibility study of the new platform among customers and also to start popularizing this software platform. The Ld. Assessing Officer (AO) during the course of the assessment proceedings treated the expenditure as capital in nature since it gives enduring benefit to the assessee disregarding the explanations given by the assessee. This decision was upheld by the Ld. CIT(A).

Aggrieved by this the assessee is in appeal before the Hon. ITAT.

Matters before Authority:

- Whether the Ld. CIT(A) was right in holding that the expenses in relation with the software development which was abandoned in the subsequent year are to be treated as capital in nature?
- Whether on the facts and in the circumstances of the case, the Ld. CIT(A) was right in assuming that the marketing expenses incurred on the overall business of the assessee to be in relation with the software development and hence treated as a capital expense?

Decision:

i. The question about the software platform giving enduring benefits only comes into picture when the new asset came into existence. Unless the product developed, comes in the form of a new product, which can be independently used, then it cannot be said that the product would give enduring benefit to the assessee.

II. In this case, the assessee was developing a new software platform but such new platform was abandoned during the subsequent financial year due to rapid change in technology and shifting of technology from desktop to mobile platform. The product has never been put to use and no depreciation has been claimed.

Iii. Further, the expenditure incurred towards development of new software platform was treated as part of revenue expenditure and has never been debited to capital work in progress in books of accounts.

iv. The expenditure incurred by the assessee towards development of new software platform was in the nature of expenditure incurred for preparation of feasibility of the new project in respect of same business, which was already carried out by the assessee, even if it was for expansion of business and definitely cannot be treated as capital expenditure incurred for development of a new product, which gives enduring benefit to the assessee.

v. The Tribunal has relied on the decision of the Hon'ble High Court of Karnataka[2] wherein the court clearly held that expenditure incurred on investigation, research and feasibility studies laid out by the assessee was revenue in nature and hence an allowable deduction.

[1] *Adadyn Technologies (P.) Ltd. v. Assistant Commissioner of Income Tax, Circle 1(1), Bengaluru*
[2] Karnataka State Industrial & Development Corporation (163 ITR 657)

Vi. Further, the Accounting Standard-26 prescribed by ICAI for the treatment of research and development expenses, clearly lays down that these expenses should be recognized as and when they incur. The Accounting standard further states that in the research phase of the project, an enterprise cannot demonstrate that an intangible asset exists from which future economic benefits are probable.

vii. The Hon. ITAT held that the A.O. and CIT(A) erred in coming to a conclusion that expenditure incurred on developing new software platform is expected to give enduring benefit and one can recognise the intellectual property in the same to come to conclusion that expenditure incurred for development of new software platform is capital in nature.

viii. For the second appeal regarding marketing expenses, the CIT(A) never brought out clear facts about these expenses and on perusal of details filed by the assessee, the Tribunal found that marketing expenses incurred by the assessee has no nexus with the new product being developed by the assessee at the time. The A.O and the CIT(A) have clearly erred in coming to the conclusion.

ix. Hence the ITAT has ruled in the favour of the assessee and directed the A.O to delete these additions.

"The High Court of Madras held that where there is no material to support findings of Commissioner that assessee-firm was used as a device to divert excess profits, the invocation of Section 263 to revise the assessment order of the Assessing Officer was not required on the issue of deduction under section 80IB."

Case Walkthrough:

The assessee[3] is a partnership firm which consists of five partners. The partners are broadly divided in two groups, the Doshi Group which consists of three out of five partners and hold 65% of the stake in partnership and the Chandrasekaran Group consists of remaining two partners (who are brothers) holding 35% of the stake in partnership. Parents of the Chandrasekaran Group are joint owners of a land and have entered into a Joint Development Agreement on 05.01.2007 proposing a housing project. The partnership firm was incorporated on 10.10.2008. The land appears to have been developed by the Firm and the sale of flats took place during the AY 2012-13 & 2013-14. The assessee filed return of income as NIL as it had claimed deduction of profit u/s 80IB. Subsequently the case was selected for scrutiny wherein the Assessing Officer ('A.O'.) determined income of INR 23,235/-. The Principal Commissioner of Income Tax ('PCIT') invoked power u/s 263 of the Act and opined that the A.O. omitted to examine the quantum of deduction u/s 80IB. The PCIT was of the opinion that the assessee has earned revenue of INR 22.52 Cr and net profit of INR 11 Cr, which is nearly 50% of the revenue. Further PCIT state that such huge net profit margins in the business of construction is highly improbable. Based on this assumption the PCIT claimed that the net profit margin includes a major portion of gains that relates to the land sold by owners diverted into share of profit to children. Therefore, the PCIT formed an opinion that the assessee firm would be ineligible for deduction u/s 80IB(10) to the extent of 35% of share of profit. To this, the assessee contended that the sale of land was well within the guideline value fixed by the State and that there is no understatement of consideration. Further, the PCIT opined that instead of providing the sale proceeds of the proportionate share of the constructed place to the owner directly, by the arrangement of the partnership business, the assessee firm has passed on the value of sale proceeds indirectly as share of profit credited to the sons of the land owner, this according to PCIT was nothing but excess sale consideration to the land transferred by the owners. Accordingly the assessment order passed by the A.O was set aside. The assessee carried the matter to the Tribunal and the contention of the assessee was allowed.

Aggrieved by this order, The Revenue is in appeal before the Hon. High Court.

Matters before Hon. High Court:

- Whether the act of PCIT invoking power u/s 263 is in law?

[3] Commissioner of Income Tax, Chennai v. Doshi Estates

Decision:

i. The High Court found that the issue involved in the case is **wholly factual**.

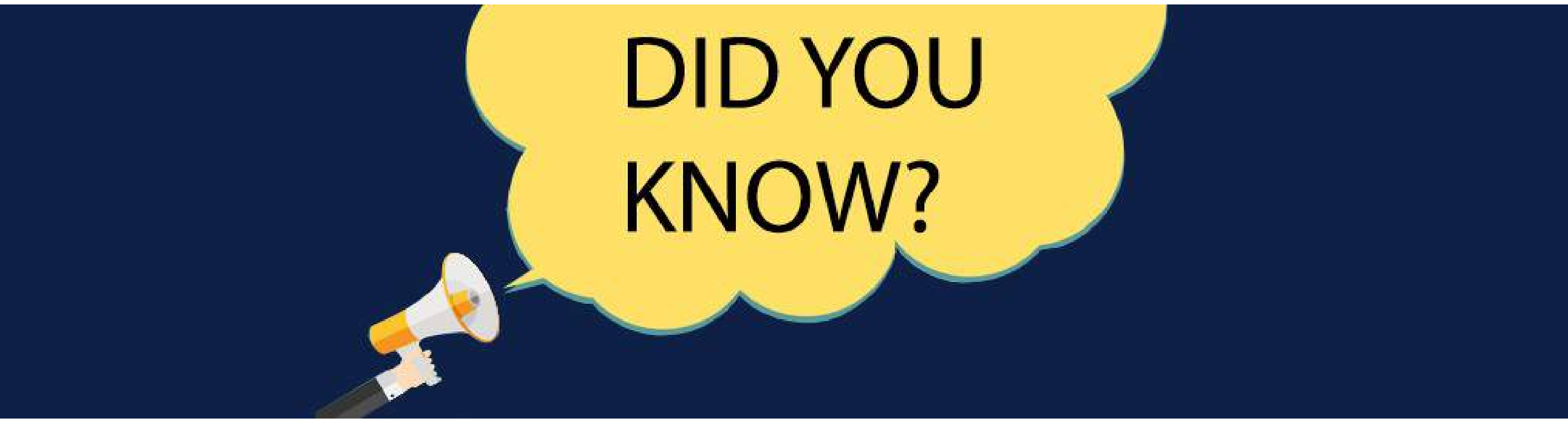
ii. The Joint Development Agreement was entered on 05.01.2007 whereas the Partnership came into existence much later. If the findings of the PCIT, that the Partnership Firm was a device adopted by the assessee to arrange its business in such a manner to produce more than the ordinary profits were to be relied upon, the partnership firm should've existed since the very beginning.

iii. There is no quarrel on the legal proposition that the guideline value fixed by the State is only an indicator of the value of the property. However in the instant case, the PCIT faulted the land owners for having sold the land at the guideline value. There was no material available before the PCIT that such guideline value was ridiculously low.

iv. In fact, the profit is being computed based on the sale which were effected during the assessment year under consideration, AY 2012-13, that is more than five years after entering into the Joint Development Agreement, four years after the Partnership Firm came into being.

v. The order passed by the PCIT is based on a hypothetical situation. There can be no presumptions and assumptions while deciding the correctness of an order of assessment, more particularly when the PCIT invokes his power under Section 263 of the Act. The Statute mandates twin conditions to be fulfilled while exercising such power and therefore there is no room to invoke such a power and in the absence of any material before the PCIT to term the Partnership Firm to be a device adopted by the assessee to earn more than the ordinary profit, there was no reason for the PCIT to interfere with the Assessment Order under Section 143(3) of the Act.

vi. Further there are no Questions of Law much less Substantial Questions of law arises for consideration in this appeal. Accordingly the Tax Case Appeal fails and dismissed.



News About Taxation You Need to Know Right Now!

1. James Wilson, the Scotsman who created India's first Budget, introduced the Income Tax in 1860. India had as many as 30 finance ministries after independence from the British in 1947.
2. Income Tax Department to validate UDIN given by CA's in tax audit reports.
3. Big relief for mid – scale companies, government postpones QR code requirement to March end next year.
4. CBDT issues refunds of over Rs. 1,36,066 crore to more than 40.19 lakh taxpayers between 1st April,2020 to 17th November,2020.
5. LTC cash voucher scheme is now available for benefit to private sectors, upto INR 36,000 can be saved.

Due dates for Compliance under Income tax

7th Dec 2020

- Due date for deposit of Tax deducted/collected for the month of November, 2020. However, all sum deducted/collected by an office of the government shall be paid to the credit of the Central Government on the same day where tax is paid without production of an Income-tax Challan

15th Dec 2020

- Third installment of advance tax for the assessment year 2021-22
- Due date for issue of TDS Certificate for tax deducted under section 194-IA in the month of October, 2020*
- Due date for issue of TDS Certificate for tax deducted under Section 194-IB in the month of October, 2020*
- Due date for issue of TDS Certificate for tax deducted under Section 194M in the month of October, 2020*

30th Dec 2020

- Due date for furnishing of challan-cum-statement in respect of tax deducted under Section 194-IB in the month of November, 2020*
- Due date for furnishing of challan-cum-statement in respect of tax deducted under section 194M in the month of November, 2020*
- Due date for furnishing of challan-cum-statement in respect of tax deducted under section 194-IA in the month of November, 2020

31st Dec 2020

- Return of income for the assessment year 2020-21 for all assessee other than (a) corporate-assessee or (b) non-corporate assessee (whose books of account are required to be audited) or (c) partner of a firm whose accounts are required to be audited or (d) an assessee who is required to furnish a report under section 92E.

  Note: The due date for filing of return has been extended to December 31, 2020 vide Press Release, dated 24-10-2020

- Due date for furnishing of various audit reports including tax audit report and report in respect of international/specified domestic transaction for the Assessment Year 2020-21*.

  Note: The due date for furnishing of various audit reports including tax audit report and report in respect of international/specified domestic transaction has been extended to December 31, 2020 vide Press Release, dated 24-10-2020.

Note: The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 has extended due dates for compliance falling during the period from 20-03-2020 to 31-12-2020. Readers are requested to please check the relevant documents from below links:
https://www.incometaxindia.gov.in/Lists/Latest%20News/Attachments/419/taxation_other_laws_relaxation_amed_certain_provisions_act_2020.pdf

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