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TAXATION TIMES

July 2021

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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Introduction

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To ease the hardship caused by the COVID 19 pandemic, the Government has extended the due dates for the filing of the income tax returns for all classes of taxpayers. With an intent to increase transparency in tax administration in India and also to ensure that a larger number of people file their tax returns, several measures are being implemented by the Government such as pre filling of income tax return forms, robust e-filing platform, interchangeability of PAN – Aadhaar, faceless assessment scheme etc. With these taxpayer friendly initiatives, it is hoped that the government can accelerate the revenue collections and bring about a larger number of people to file their tax returns.

Coming to this edition of the Taxation Times, here's what we have to offer:

- Owing to digitalization, the world has become a global village. More and more companies are increasingly earning incomes in a jurisdiction which is different from the jurisdiction of their tax residency. The CBDT notified Foreign Tax Credit Rules (FTC) in order to enable taxpayers claim credit of taxes withheld in a different jurisdiction. Read about the provisions of FTC here.
- Judgements delivered by the Hon'ble High Court of Karnataka & the Hon'ble Chennai ITAT.
- Tax News from around the world.
- Circulars & Notifications for July 2021.
- Upcoming compliances for August 2021.

We hope that you find this edition of the Taxation Times useful. Incase you have any feedback or need us to include any information to make this issue more informative, please feel free to write to us at info@uja.in

Happy Reading!

Best Regards,
UJA Tax Team

What is Foreign Tax Credit and how to claim it?

With the advent of globalization, the world has become smaller. Digitalization and technology have made it possible for businesses to connect with each other across different parts of the world. Physical presence no longer matters and organizations around the world work hand in hand and support each other. This has led organizations to generate income in another jurisdiction from the one it is a tax resident. As per the provisions of the Income Tax Act 1961, a person resident in India is eligible to pay taxes on it's global income. When such a person earns income in another jurisdiction, taxes are withheld on the income and taxes are also required to be paid on the same income in India. This results in double taxation of the same income.

To provide relief to taxpayers and also to ease burden of double taxation, India has signed Double Taxation Avoidance Agreements (DTAA) with several jurisdictions. One of the objective or intent of a DTAA is to avoid double taxation of income by allocating the right of taxation between the source country and the country of residence of the recipient.

A DTAA provides for relief from double taxation under two methods:

- Exemption Method
- Credit Method

In this article, we elaborate the mechanism to avail relief from double taxation under the tax credit method. There has always been a challenge to compute foreign tax credit (FTC). The Central Board of Direct Taxes ('CBDT') vide notification No. 54/2016 introduced Rule 128 in the Income – Tax Rules. Rule 128 became effective from 1st April 2017 and prescribed the broad principles to compute and claim credit of taxes paid in another jurisdiction. The intent of the said rules was to bring clarity and reduce the hassle in claiming credit of taxes paid in a foreign country.

Certain points in connection with FTC are elaborated below:

What is Foreign Tax Credit?

The provisions of Rule 128 state that a taxpayer being a resident shall be allowed credit for the amount of foreign tax paid by him in a country or a specified territory outside India, by way of a deduction or otherwise.

Foreign Tax means:

a. In respect of a country or specified territory outside India with which India has entered into an agreement for the relief of or avoidance of double taxation in terms of s. 90 or s. 90A of the Income Tax Act 1961 ('ITA');

b. In respect of any other country or specified territory outside India, the tax payable under the law in force in that country or specified territory in the nature of income – tax referred to in clause (iv) of the Explanation to section 91.

When is the Foreign Tax Credit available to the assesse?

The FTC becomes available to the assesse in the year in which the income corresponding to such tax has been offered to or assessed to in India. However, in case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across all those years in the same proportion in which the income is offered to or assessed to tax in India.

What can be included or excluded from foreign tax credit?

As per Rule 128 :

a. FTC shall be allowed in respect of the amount of tax, surcharge and cess payable under the ITA but not in respect of interest, fee or penalty;

b. FTC shall not be available in respect of any amount of foreign tax or part thereof which is disputed in any manner. However, the credit of such disputed tax shall be allowed in the year in which such income is offered to tax or assessed to tax in India if the assessee within six months from the end of the month in which the dispute is settled furnishes evidence of settlement of dispute.

Which documents are required to be furnished in order to claim credit of foreign taxes paid?

a. A statement of income from the country or specified territory outside India offered for tax in the previous year and of foreign tax deducted and paid on such income in Form No. 67;

b. Certificate or statement specifying the nature of income and amount of tax deducted or paid by the assessee-

i. From the tax authority of the country or the specified territory outside India; or

ii. From the person responsible for deduction of such tax; or

iii. Signed by the assessee. A statement signed by the assessee shall be valid if accompanied by:

- An acknowledgment of online payment or bank counterfoil or challan for payment of tax where the payment has been made by the assessee;
- Proof of deduction where the tax has been deducted.

How does one compute the amount of FTC?

The credit of FTC shall be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country or a specified territory outside India and shall be given effect in the following manner:

a. The credit shall be lower of tax payable under the ITA on such income and foreign tax paid on such income. However, where the foreign tax paid exceeds the amount of tax payable in accordance with the provisions of the agreement for relief of double taxation, such excess shall be ignored for the purpose of this clause;

b. The credit shall be determined by the conversion of currency of payment of foreign tax at the telegraphic transfer buying are on the last month immediately preceding the month in which the taxes are paid or deducted.

What is Form 67?

For an assessee to claim credit of foreign taxes, a declaration in Form 67 is required to be submitted. Form 67 needs to be filed online prior to the submission of the assessee filing the return of income.

Form 67 is available on the e-filing portal of the Income Tax Department. For an assessee that files income tax return electronically, Form 67 is required to be prepared and submitted online.

Procedure to file Form 67:

a. Login to the income tax portal with registered ID and password.

b. Follow the link : E-File – Income Tax Forms – File Income Tax Return Forms – Person not dependent on any source of income (source of income not relevant) – Page 2 – Form 67.

c. Select Form 67 and the assessment year.

d. Relevant details as under are required to be filled in Form 67:

i. Name of Country/ specified territory.

ii. Source of income.

iii. Income from outside India.

iv. Tax paid outside India.

v. Tax payable of such income under normal provisions of India.

vi. Tax payable on such income under s. 115JB/JC.

vii. Details of credit under s. 90/90A.

Conclusion

The introduction of Rule 128 has to some extent settled certain issues. However, there still are certain grey areas which need to be addressed. For instance:

a. India follows the accounting period from April – March whereas most of the countries follow the calendar year i.e January – December. This gives rise to certain variances in the income reported overseas, taxes paid overseas vis-à-vis income to be assessed to tax in India and FTC to be claimed in India in connection with such income.

b. There is no document which is a valid proof for deduction of taxes withheld outside India and needs to be uploaded with Form 67.

Even though these rules were notified and effective since April 2017, the CBDT should consider the practical challenges which taxpayers face at the time of filing of Form 67 to claim FTC and clarify these in order to avoid potential litigation threats.

Case Law

Depreciation can be claimed on plant and machinery even when the asset is installed and ready to use but not put to use in business.

Facts

The taxpayer[1] is engaged in the business of manufacture of components, sub assembly for motors and tools etc. The taxpayers case was selected for scrutiny for AY 2013 – 2014 & addition was made to the returned income disallowing expenses relatable to exempt income under s. 14A of the Income Tax Act 1961 ('ITA') and disallowance of depreciation claimed on plant and machinery on the ground that assets were not put to use in the business of the taxpayer for the relevant AY.

The taxpayer had various additions to plant and machinery and the same were installed before 30th March 2013. The taxpayer has claimed depreciation as per the provisions of section 32 of the ITA and further, wherever assets were put to use for less than 182 days, the taxpayer has claimed half of actual depreciation allowable as per the ITA. The Ld. Assessing Officer ('AO') has disallowed depreciation claimed on plant and machinery on the ground that although plant and machinery was installed and commissioned before 30.03.2013, but the same has not been put to use in the business of the taxpayer. Therefore, claim of depreciation cannot be allowed unless the assets are put to use in the business of the taxpayer for the relevant assessment year. To come to said conclusion, the AO has relied upon production of finished goods furnished by the taxpayer and argued that in one day such a huge quantity of finished goods cannot be produced. He has also held that assets were not in fact, put to use in the business and hence rejected the depreciation claim on said plant and machinery.

The Hon'ble CIT(A) deleted the additions made by the Ld. AO. Aggrieved by the order of the Ld. CIT(A), the Revenue has preferred this appeal before the Hon'ble ITAT.

Issue

Can depreciation be claimed on plant and machinery which is installed and commissioned before the end of the AY but not put to use?

Decision

1. The Ld. CIT(A) relied on the decision of the Hon'ble Madras High Court in the case of Chennai Petroleum Corporation Ltd.[2] and the Hon'ble Bombay High Court in the case of Whittle Anderson Ltd[3] on the ground that where machinery is ready for use though actually not used, depreciation is admissible.
2. The Ld. Departmental Representative (DR) on behalf of the Revenue has submitted that the CIT(A) has erred in deleting the disallowance of depreciation though it was not established that plant & machinery have been put to use during the relevant previous year.
3. The Ld. Authorised Representative (AR) on behalf of the taxpayer submitted that the taxpayer had placed on record all evidences to prove that the plant and machinery was put to use in the business of the taxpayer and based on these evidences, the Ld. CIT(A) was correct in deleting the disallowance made by the Ld. AO. The taxpayer had placed on record plant and machinery installation report, as per which the plant and machinery was installed on 30.03.2013 and the same was put to use for production of finished goods. The taxpayer has also placed on record finished goods produced from the plant & machinery installed and commenced. Therefore, the AO merely on the basis of surmises and conjectures has concluded that although plant & machinery was installed, the same was not put to use.
4. The Hon'ble ITAT held that on the basis of the commissioning report of the plant & machinery placed on record, it is quite evident that the plant and machinery were acquired and installed before the end of the financial year. In fact, the taxpayer also submitted on record production details of finished goods from the newly installed plant & machinery. On the basis of the evidences placed on record, it is understood that the AO has erred in disallowing depreciation on plant & machinery on the assumption and surmises that in one day so many single units cannot be produced and the same is not based on any facts & figures. The ITAT has taken the view that depreciation claimed on plant & machinery which was installed and put to use in the business of the taxpayer cannot be denied. Further, suppose assuming that the asset has not been put to use but ready to use in the business for the relevant assessment year, the claim of depreciation can be allowed. Therefore, the finings of the CIT(A) deleting the disallowance of depreciation made by the AO are upheld.

1 DCIT V/s Agile Electric Sub Assembly (P) Ltd (2021) 127 taxmann.com 541 (Chennai – Trib)

2 CIT v. Chennai Petroleum Corpn. Ltd. [2013] 37 taxmann.com 332/218 Taxman 228/358 ITR 314 (Mad.)

3 Whittle Anderson Ltd. v. CIT [1971] 79 ITR 613 (Bom.)

When the taxpayer had made a provision for warranty made on the basis of machine months, then such provision for warranty is on a scientific basis and method and impugned provision towards such warranty is to be allowed.

When the taxpayer had paid a market support fee and transition support fee for carrying on business efficiently, such expenditure is revenue in nature and to be allowed under s. 37(1) of the Income Tax Act 1961.

Facts

The taxpayer[4], a wholly owned subsidiary of Lenevo Asia Specific Limited, Hong Kong is a company engaged in the business of manufacture, import, marketing, distribution and export of information technology systems. The taxpayer filed an original return of income for AY 2007 – 2008 and subsequently a revised return of income was filed. The case of the taxpayer was selected for scrutiny and the Ld. Assessing Officer (AO) disallowed a provision for warranty made by the taxpayer on the ground that the estimate with regard to provision for warranty has not been made on a reliable basis but on an adhoc basis & therefore it is a contingent and unascertained liability. The Ld. AO also held that market support fee and transition support fee incurred for smooth carrying of business is of enduring nature and hence the same is capital in nature and therefore needs to be disallowed.

The Ld. Commissioner of Appeals [CIT(A)] affirmed the order passed by the AO. Thereafter, the taxpayer approached the Income Tax Appellate Tribunal (ITAT) which allowed both the claims of the taxpayer.

Aggrieved, by the order of the Hon'ble ITAT, the Revenue has preferred an appeal before the Hon'ble High Court.

Issue

1. Can the provision for warranty made by the taxpayer on the basis of machine hours be allowed as a deduction under s. 37(1) of the Income Tax Act 1961 (ITA)?
2. Are the market support fees and transition support fee paid by the taxpayer in the nature of revenue expenditure or capital expenditure?

Contentions by the Sr. Counsel for the taxpayer & revenue :

1. The Hon'ble ITAT had allowed the claim of the taxpayer on account of provision for warranty placing reliance on the decision of the Hon'ble Supreme Court in the case of Rotork Controls India (P) Ltd[5] and the decision by the Tribunal in the case of the taxpayer for AY 2011 – 2012 holding that the provision for warranty is on a scientific basis and hence allowed. The ITAT also held that market support fees and transition support fee is an expenditure under s. 37(1) of the ITA.
2. The Ld. Counsel for the revenue before the High Court stated that the AO and CIT(A) has rightly disallowed the provision made for warranty in excess of which was actually incurred by the taxpayer. The Hon'ble Tribunal has not appreciated the fact that the provision for warranty made by the taxpayer is excessive and irrational and data relied upon by the taxpayer was maintained by IBM which was not relevant in the Indian context. Also, the Hon'ble ITAT has erred in applying the decision of the Supreme Court in the case of Rotork Controls (P) Ltd to the present case. Further, the market support fee and transition support fee has been incurred with a view to acquire an enduring benefit for it's business and therefore such expenditure is capital in nature and hence should not be allowed under s. 37(1) of the ITA.
3. The Ld. Counsel for the taxpayer submitted that the Hon'ble ITAT being the last fact-finding authority has correctly recorded that provision for warranty made by the taxpayer is on a scientific basis and the pre-requisites laid down in Rotork Controls (P) Ltd have been fulfilled by the taxpayer.

   Also, the marketing fee and support transaction fee which has been incurred for maintaining operating revenue is rightly treated as operating revenue. The nature & test of enduring benefit is not the sole criteria to determine the nature and character of an expenditure. It was also pointed out at the Tribunal has allowed the similar expenditure in the case of the taxpayer for AY 2006 – 2007.

Decision

1. The Hon'ble High Court observed that the Hon'ble Supreme Court that in the case of Rotork Controls (P) Ltd, three tests for permitting claim for deduction on account of provision for warranty viz. (*i*) the assessee has to establish that there is a present obligation on account of past event, (*ii*) working out the probable estimate of the outflow of resources required and (*iii*)

4 PCIT, Bangalore V/s Lenevo India (P) Ltd [2021] 127 taxmann.com 487 (Karnataka)

5 Rotork Controls India (P.) Ltd. v. CIT [2009] 180 Taxman 422/ 314 ITR 62 (SC)

assessee has to substantiate the reliability of such estimate. The Tribunal has relied on the order passed in the taxpayers own case for AY 2011 – 12. And has held that the taxpayer had taken over the business from IBM which had substantial experience in such business and if the taxpayer has relied on the methodology adopted by the IBM for working out the warranty provision, the same cannot be said to be incorrect. The taxpayer had made a provision for warranty based on machine months and the said method cannot be held to be not scientific.

The taxpayer has fulfilled the conditions laid down in Rotork Controls (P) Ltd & the Hon'ble ITAT has recorded a finding that the provision for warranty made by the taxpayer is on a scientific basis and has allowed the claim for deduction on account of warranty made by the taxpayer made on scientific basis. The aforesaid finding has not been demonstrated as perverse by the Ld. Counsel for the Revenue. Thus, the Hon'ble ITAT has rightly relied on the decision in the case of Rotork Controls (P) Ltd. A similar finding has also been taken in the case of IBM Limited.[6]

2. The Hon'ble High Court observed that in the case of market support fee and transaction support fee paid, the Tribunal has relied on the decision in the case of the taxpayer itself for AY 2007 – 07 and AY 2008 – 09 wherein the ITAT had taken into account market support services to be delivered by IBM to the taxpayer to facilitate sale of products by the taxpayer and to extend services to the customer to one or more subsidiaries or third parties under contract with the seller/IBM or one of its subsidiaries. Thus, the tribunal has held that the services rendered by the IBM are for smooth carrying of business for a period of five years and it might give an enduring benefit to the taxpayer but every activity which gives an enduring benefit to the taxpayer would not get the character of capital in nature. It was further held that enduring benefit is not the only criteria to decide the nature and character of expenditure. The necessary test is whether it is for acquisition of any capital asset or for the purpose of carrying on the business deriving revenue from it. Therefore, it has been held that the fees paid by the taxpayer for marketing support services rendered by IBM is revenue in nature and is allowable under section 37 of the ITA. In *CIT, T.N.* the Supreme Court has held that in order to ascertain whether the expenditure is revenue or capital in nature one has to look at the expenditure from commercial point of view and even saving in expenditure was held to be saving in revenue expenditure. In respect of the expenditure incurred by the assessee for getting marketing support services, the assessee cannot claim any depreciation. It has further been held in *Empire Jute Co. Ltd.*[7] that test of enduring benefit is not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to particular facts and circumstances of a given case. Therefore, in the fact situation of the case, the tribunal has rightly allowed the expenditure incurred towards marketing support fee and transit support fee under section 37(1) of the Act.

6 *CIT* v. *IBM India Ltd.* [2014] 43 taxmann.com 470/[2013] 357 ITR 88 (Kar.)

7 *Empire Jute Co. Ltd.* v. *CIT* [1980] 124 ITR 3 (SC)

Tax in the News

MAS chief says wealth tax could tackle wealth inequality in Singapore.

https://www.straitstimes.com/singapore/politics/mas-chief-says-wealth-tax-could-tackle-wealth-inequality-in-singapore

Ireland seeks input on OECD tax proposals' impact on Irish tax policy.

https://mnetax.com/ireland-seeks-input-on-oecd-tax-proposals-impact-on-irish-tax-policy-45154

India joins global consensus framework to tax multinational firms.

https://www.reuters.com/world/india/india-joins-global-consensus-framework-tax-multinational-firms-2021-07-02/

EU 'Green Deal' includes energy tax changes, carbon border adjustment mechanism.

https://mnetax.com/eu-green-deal-includes-energy-tax-changes-carbon-border-adjustment-mechanism-45095

France pushes for 25% target for taxing multinationals' super profits.

https://www.reuters.com/business/finance/france-pushes-25-target-taxing-multinationals-super-profits-2021-07-10/

New multinational tax allocation rules will 'overlay' transfer pricing rules, OECD official says.

https://mnetax.com/new-multinational-tax-allocation-rules-will-overlay-transfer-pricing-rules-oecd-official-says-45090

Tax on multinationals scares Singapore.

http://www.asianews.it/news-en/Tax-on-multinationals-scares-Singapore-53713.html

Circulars, Notifications & Press Release

A. Circulars:

Guidelines under section 9B and sub-section (4) of section 45 of the Income-tax Act, 1961 (Deemed Transfer):

Finance Act, 2021 inserted a new section 98 in the Income-tax Act 1961. Whenever a specified person receives any capital asset or stock in trade or both from a specified entity, during the previous year, in connection with the dissolution or reconstitution of such specified entity, then it shall be deemed transfer such capital asset or stock in trade or both to the specified Person and any profits and gains arising is taxed under head 'Capital Gains' in year in which is it received by the specified person.

https://www.incometaxindia.gov.in/communications/circular/circular_14_2021.pdf

B. Notifications:

The CBDT amends Rule 8AA of the Income tax Rules 1962, in correlation to insertion of section 45 sub-section 4 under the Income Tax Act, 1961.

https://www.incometaxindia.gov.in/communications/notification/notification_76_2021.pdf

The CBDT notify new Rule 8AC 'Computation of short term capital gains and written down value under section 50 where depreciation on goodwill has been obtained.'

https://www.incometaxindia.gov.in/communications/notification/notification_77_2021.pdf

Central Government approves 'M/s Patanjali Research Foundation Trust, Haridwar' under category of *'Research Association'* for section 35(1)(ii) of the Income Tax Act, 1961 read with rule 5C and 5D of income tax Rules, 1962. Which means any payment made to M/s Patanjali Research Foundation trust for conducting any Scientific Research will be eligible for deduction u/s 35.

https://www.incometaxindia.gov.in/communications/notification/notification_79_2021.pdf

C. Press Release

The CBDT has decided to extend the due date for manual submissions of the aforesaid forms to authorised dealers till 15th August 2021.

https://www.pib.gov.in/PressReleasePage.aspx?PRID=1737217

The Government has decided to provide income tax exemption to the amount received by a taxpayer for medical treatment from an employer or from any person for treatment of COVID-19 during the financial year 2019-20 and subsequent years.

https://www.pib.gov.in/PressReleasePage.aspx?PRID=1736879

Upcoming Compliances for August 2021

7 August 2021

Due date for deposit of Tax deducted/ collected for the month of July, 2021.

14 August 2021

Due date for issue of TDS Certificate for tax deducted under section 194-IA, 194-IB and 194M in the month of June, 2021.

15 August 2021

Due date for furnishing of Form 24G by an office of the Government where TDS/ TCS for the month of July, 2021 has been paid without the production of a challan.

Quarterly TDS certificate (in respect of tax deducted for payments other than salary) for the quarter ending June 30, 2021.

30 August 2021

Due date for furnishing of challan-cum-statement in respect of tax deducted under section 194-IA, 194-IB and 194M for the month of July, 2021.

31 August 2021

Payment of tax under the Direct Tax Vivad se Vishwas Act, 2020 without additional charge.

The due date for payment of tax under the Direct Tax Vivad se Vishwas Act, 2020 without additional charge has been extended to June 30, 2021 vide Notification S.O. 1704 (E), dated 27-04-2021 further extended from June 30, 2021 to August 31, 2021 vide Circular no. 12/2021, dated 25-06-2021.

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