Direct Tax

amicus

February 2025 / Issue –125

An e-newsletter from
Lakshmikumaran & Sridharan, India

Lakshmikumaran Sridharan attorneys
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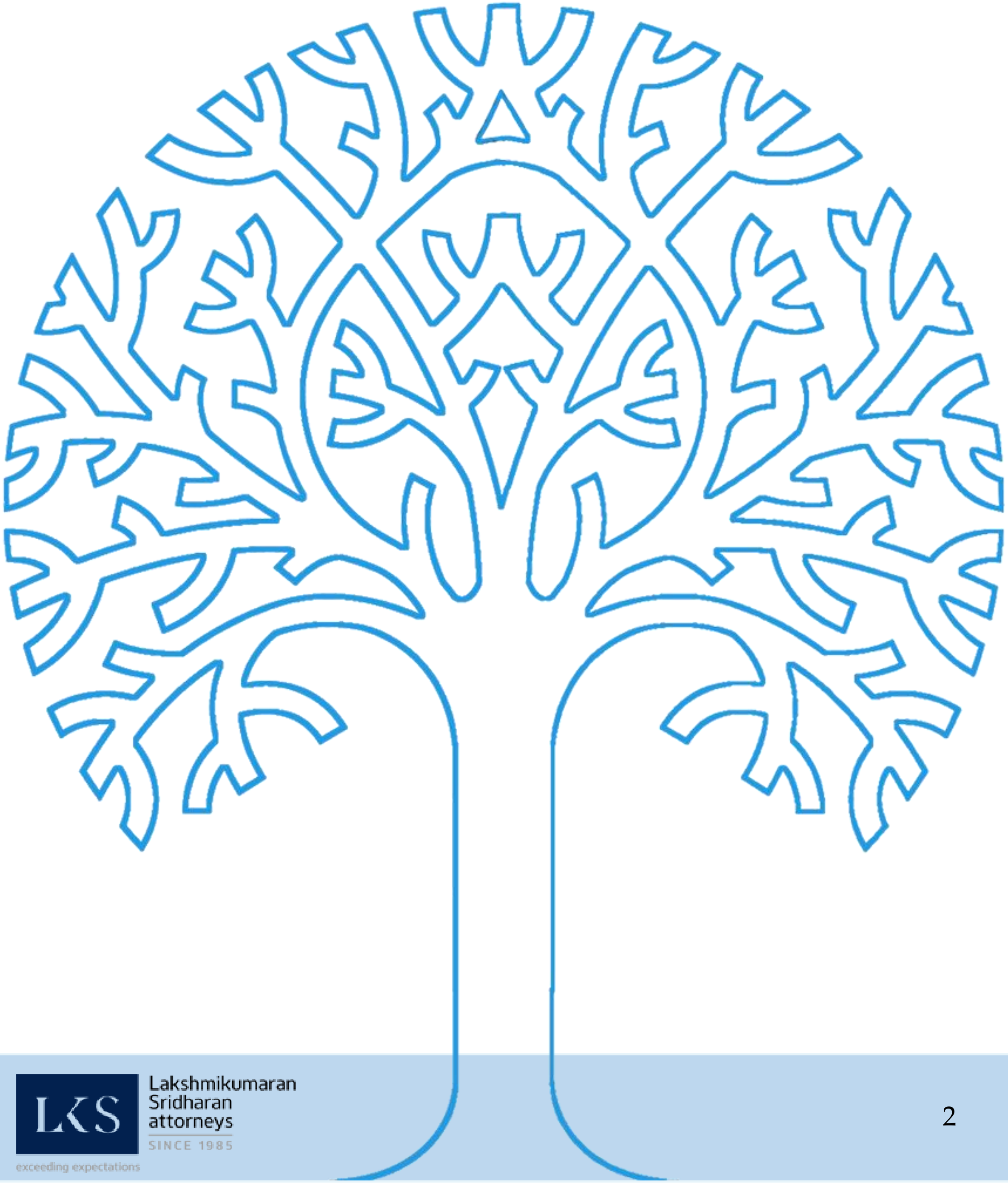
Table of Contents

Article **3**

Capital reduction: End of the road for taxpayer fate?..4

Notifications & Circulars **9**

Ratio Decidendi... **14**



Article

Capital reduction: End of the road for taxpayer fate?

By **Varshini UJ**

The Supreme Court recently upheld the Bombay High Court decision that the complete reduction of capital (resulting in cancellation of shares) amounts to 'transfer' in terms of Section 2(47) of the Income Tax Act, 1961 and the consequent payout would be exigible to tax under the head capital gains. As a corollary, the resultant loss incurred by the taxpayer was allowed to be claimed. The article in this issue of Direct Tax Amicus attempts to explore the possible fate of the taxpayers to claim capital loss in a scenario where no payout is received pursuant to a reduction in share capital. The article discusses a decision of the Special Bench of the Mumbai Tribunal and observes that the matter is yet to attain finality in cases where no payout is received, and the capital reduction is by way of reducing the face value of shares.

Capital reduction: End of the road for taxpayer fate?

By Varshini UJ

Introduction

The Supreme Court recently in *Jupiter Capital*[1] upheld the ruling of Bombay High Court that the complete reduction of capital (resulting in cancellation of shares) would be tantamount to transfer in terms of Section 2(47) of the Income Tax Act, 1961 ('**IT Act**') and the consequent payout would be exigible to tax under the head capital gains. As a corollary, the resultant loss incurred by the taxpayer was allowed to be claimed. The Supreme Court decision is a welcome one, in re-assuring the taxpayer's right to claim capital loss arising from capital reduction especially in a scenario where a **payout** is received.

However, it should be noted that the Special Bench of the Mumbai Tribunal in *Bennett Coleman*[2] dealt with an issue of whether pursuant to a scheme of capital reduction by way of reduction in face value and where **no payout** was received by the taxpayer, the said transaction would be subject to income-tax under the head 'Capital gains'. In that case, the Tribunal at the outset held that there was no transfer. Further, placing reliance in the decision of the Hon'ble Supreme Court in *B C Srinivasa Shetty*[3], it was held that absent any payout, the computation mechanism would in any case fail and therefore, the transaction would not be subject to income-tax under the head 'Capital gain'. Consequently, no loss was allowed to be set off and carried forward by the taxpayer.

In this backdrop, the article attempts to explore the possible fate of taxpayers to claim capital loss in a scenario where **no payout** is received pursuant to a reduction in share capital.

Extinguishment of rights *vide* reduction of share capital amounts to 'transfer'

Section 2(47) of the IT Act defines 'transfer' to *interalia* include (a) any sale, exchange or relinquishment of the capital asset or (b) extinguishment of any rights therein.

The Hon'ble Supreme Court in *Kartikeya V. Sarabhai*[4] dealt with an issue of whether reduction in face value of shares

1 [2025] 170 taxmann.com 305 (SC) – SLP filed by Revenue against Bom HC judgment dismissed.
2 [2011] 12 ITR (T) 97 (Mumbai)
3 [1981] 128 ITR 294 (SC)
4 (1997) 7 SCC 524

without reduction in number of shares will amount to transfer within the meaning of Section 2(47) of the IT Act and consequently, whether the **payout received** by the taxpayer is exigible to income tax under the head 'Capital gains'. In the said case, it was observed that upon reduction in face value of shares, the taxpayers' voting rights as well as dividend receivable stood extinguished proportionately in terms of Section 87 of the Companies Act, 1956[5]. The Hon'ble Supreme Court observed that 'transfer' under Section 2(47) not only includes sale of a capital asset but also includes relinquishment or extinguishment of any rights over such asset. Therefore, it was held that such a reduction of the right in the capital asset as a result of reduction in face value of shares clearly amounts to a transfer within the meaning of Section 2(47) IT Act. Consequently, the resultant gains in the hands of the taxpayer were subject to income tax as 'capital gains'. The aforesaid decision of the Hon'ble Supreme Court was followed in another decision of the Court in *G. Narasimhan*[6] wherein a similar proposition was laid down. It is interesting to note that even in the said case, the taxpayer **received a payout** in connection with the capital reduction.

It can be understood from the above decisions that in cases where it can be ascertained that rights of the taxpayer stand extinguished pursuant to a capital reduction and a payout is received, capital loss of the taxpayer can be carried forward.

Moving forward, the relevance of existence of a payout and the manner of effecting capital reduction will be discussed in the ensuing paragraphs.

Face value reduction without payout

The charging section for 'Capital gains' under the IT Act is provided in Section 45 wherein any profits or gains arising from the transfer of a capital asset is chargeable to income tax under the head 'Capital gains'. Further, the mode of computing the income chargeable to income-tax under the head 'Capital Gains' is provided in Section 48 in terms of which the income chargeable under Section 45 is computed by reducing the cost of acquisition ('**COA**') of an asset from the full value of consideration (payout received) received on transfer of capital asset. Therefore, the essential ingredients for charging of income under Section 45(1), are (a) transfer of a capital asst, (b) determinable consideration accruing on such transfer, and (c) determinable COA for such transfer. In terms of the principle

[5] Corresponding to Section 47(2) of the Companies Act, 2013

[6] [1999] 236 ITR 327 (SC)

laid down by the Hon'ble Supreme Court in *B.C. Srinivasa Setty*[7], if any one of the essential ingredients fails, the levy would fail.

With the recent decision of the Supreme Court, the law with respect to taxability of income under the head 'Capital Gains' is settled in scenarios where a **payout is received** by the taxpayer on a complete capital reduction (other than face value reduction). However, in *Bennett Coleman* the Special Bench of the Mumbai ITAT held the taxpayer cannot claim capital loss on reduction of face value of shares for the below-mentioned reasons;

a. Even after the capital reduction the percentage of shareholding of the taxpayer in the investee entity remained the same. The loss suffered by the taxpayer was in respect of the investment made by the taxpayer. For the loss to be allowable as 'capital loss' the conditions under Section 2(47) should stand satisfied. However, in the present case, unlike in *Kartikeya V. Sarabhai* the voting rights of the shareholder remained the same vis-à-vis other shareholders. Therefore, no rights in the capital assets stood extinguished before and after the capital reduction.

b. In the absence of a specific provision to deem the FVC as zero and with no change in the intrinsic rights of the shareholders *vis-à-vis* the company, the ratio in *B.C. Srinivasa Setty* wherein it was held by the Apex Court that the levy under Section 45 fails in a case of indeterminable COA, will hold water. Further, the aforesaid ratio will also apply in a case where FVC is indeterminable like in the present case.

In this backdrop, it is relevant to note that the case in *B.C. Srinivasa Setty* related to transfer of a business undertaking which includes liabilities, unrecorded assets, etc., for which the COA cannot be reasonably determined. It was in this context that the Supreme Court held that when COA is not determinable, the levy would fail. The key point that needs to be answered is whether the dictum of the Apex Court that computation mechanism fails for 'indeterminable cost' can also be extended to even cases where consideration is NIL or no payout_is received. It is worthy to note that the factual matrix in which the judgment of *B.C. Srinivasa Setty* insofar as not

[7] [1981] 128 ITR 294 (SC)

being able to determine the value of assets of a going concern is entirely distinct to a case of capital reduction. In a capital reduction without payout the value of the shareholding, post the reduction, will still be determinable. In that case, the ratio as held by the Apex Court cannot be extended wherein the taxpayer does not receive a payout as a result of the capital reduction by way of reduction in face value.

In a recent case of *Tata Sons Limited*[8] the Mumbai ITAT dealt with a case wherein no payout was received by the taxpayer pursuant to a capital reduction by cancellation of equity shares. The ITAT distinguished the Special Bench decision in *Bennet Coleman* and further held that the principle laid down in *B.C. Srinivasa Setty* will have no role to play in cases where the COA or FVC is conceivable or ascertainable but is 'Nil'. Further, reliance was placed in the decision of the Gujarat High Court in *Jaykrishna Harivallabhdas*[9] wherein it was held that where <u>no payout</u> was received by the taxpayer on liquidation of the investee company, the taxpayer was allowed to claim the capital loss under Section 46(2) read with Section 48. In *Jaykrishna Harivallabhdas* the High Court refuted the argument advanced by the Revenue insofar as stating that where no payout is received the loss arising therefrom is not allowable since, the language employed in Section 46(2) deems the '*money received*' less dividend as the full value consideration. The Hon'ble High Court held that the in order to bring the deeming fiction envisaged under Section 46(2) to a logical end, even in cases of Nil consideration, the provision should apply.

Therefore, even in a case where **no payout** is received pursuant to a share cancellation, *Tata Sons Limited* and with the strength of *Jaykrishna Harivallabhdas* will hold ground and be of some relief to taxpayers in claiming the capital loss arising from such transaction.

However, with respect to capital reduction through reduction of face value, despite the decision of *Kartikeya Sarabai* holding that even instances of face value reduction constitutes transfer, the decision of Bennet Coleman appears to have opened the pandoras box again. The fundamental question that needs to be answered by the higher Courts in this matter is whether at all the shareholder loses any rights where capital reduction is carried out by merely lowering the face value.

Deeming fiction under Section 50CA

Though the present judgment has not discussed the impact of Section 50CA, in light of the above discussion regarding the

[8] [2024] 158 taxmann.com 601 (Mumbai - Trib.)

[9] [1998] 231 ITR 108 (Gujarat HC)

interplay of Nil consideration and charge under the head 'capital gains', it is worthy to explore how the situation will play out where a deeming provision is in place.

Where the capital asset is an unquoted share which is subject to capital reduction, Section 50CA stipulate what should be adopted as the full value of consideration notwithstanding that the actual consideration is a lesser value. A question that arises here is whether a taxpayer can argue that the said deeming provision should not apply where no consideration is received and whether such an argument would be contrary to the position taken that cases of no payout would also be subject to tax under the head capital gains. It is relevant to notice the language of Section 50CA which is as follows:

> "*Where the consideration received or accruing as a* ***result of the transfer*** *by an assessee* ***of a capital asset****,* ***being share of a company other than a quoted share****…*"

From the reading of Section 50CA it can be understood that the consideration brought to tax *vide* the aforesaid provision is as a result of 'transfer of a share other than quoted share'. That being the case, a position can be taken by tax payers that Section 50CA will apply only if the shares are transferred in its entirety and not to 'transfer' by way of extinguishment of some rights in the shares. Therefore, the aforesaid position may bear fruit with respect to capital reduction by way of face value reduction or partial cancellation of unquoted shares. However, it should be noted that the above position has not been tested before courts.

Conclusion

In light of the Supreme Court judgment in *Jupiter Capital*, the principle of law with respect to whether allowability of capital loss in cases where payout is received on cancellation of shares is re-affirmed. However, in view of the Special Bench decision in *Bennet Coleman* the matter is yet to attain finality in cases where no payout is received, and the capital reduction is by way of reducing the face value of shares. This might pose as a hardship to taxpayers due to the possibility of the Revenue authorities litigating the admissibility of capital loss.

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Notifications & Circulars

- TDS exemption in respect of purchases made from IFSC units
- TCS on sale of goods – Exemption to IFSC units on purchases
- Vivad se Vishwas Scheme, 2024 – Removal of Difficulties in respect of 'pending appeals'
- Special provisions regarding operation of cruise ships by non-residents – New rule introduced
- Venture Capital Funds and Finance Companies in IFSCs – New conditions in Income Tax Rules
- Principal Purpose Test in India's DTAAs – Guidance

TDS exemption in respect of purchases made from IFSC units

The CBDT *vide* Notification No. S.O. 21(E) dated 2 January 2025, provides an exemption from tax deduction under Section 194Q of the Income Tax Act, 1961, in respect of transactions of sale made by a seller that is a Unit of an International Financial Services Centre (‘**IFSC**’). This exemption applies subject to certain conditions. The seller must provide a statement-cum-declaration, as specified in Form No. 1 giving details of the previous years relevant to ten consecutive assessment years for which the seller opts for deductions under Section 80LA. This declaration must be verified for each relevant year. Upon receipt of the declaration, the buyer is not required to deduct tax on payments made or credited after that date and must report such payments in their tax deduction statement. However, this relaxation is only available during the specified ten consecutive years, after the expiry of which tax deductions must still be made. Additionally, the seller must remain a Unit within the definition of an IFSC as per the IT Act and the Special Economic Zones Act, 2005. The Principal Director General of Income-tax (Systems) will ensure secure data capture, transmission, and document uploading for compliance. This notification comes into effect from 1 January 2025 and aims to simplify tax compliance for transactions involving IFSC Units within SEZs.

TCS on sale of goods – Exemption to IFSC units on purchases

The CBDT *vide* Notification No. 99(E) dated 6 January 2025 specifies that a unit of International Financial Services Centres (IFSCs) shall not be considered as a buyer for the purposes of Section 206C(1H) when purchasing goods from a seller, subject to certain conditions. According to the notification, such a unit will not be considered a buyer for tax collection purposes, provided the following conditions are met:

1. The buyer (IFSC unit) must furnish a statement-cum-declaration in Form No. 1A to the seller, detailing the previous years relevant to ten consecutive assessment years for which the buyer claims deductions under section 80LA of the IT Act.
2. The buyer must verify the statement-cum-declaration for each of the previous years relevant to the ten consecutive assessment years for which the buyer opts to claim deduction u/s 80LA(1A) and (2).

3. The seller shall not collect tax on payments made by the buyer after receiving the statement-cum-declaration and furnish the details of all such payments on which tax has not been collected, in pursuance of this notification, in their tax collection statement.

This relaxation is applicable only for the previous years relevant to the ten consecutive assessment years declared by the buyer for claiming deductions under Section 80LA. The seller is liable to collect tax for payments received for any other year. The Principal Director General of Income-tax (Systems) or Director General of Income-tax (Systems) will establish procedures, formats and standards to ensure the secure capture and transmission of data. The notification came into effect from 1 January 2025.

Vivad se Vishwas Scheme, 2024 – Removal of Difficulties in respect of 'pending appeals'

The CBDT has issued an Order on 20 January 2025 on implementation of the Direct Tax Vivad Se Vishwas Scheme, 2024. The said scheme came into effect from 1 October 2024. The following matters could not be settled under the scheme:

1. An order has been passed on or before the specified date i.e., 22 July 2024
2. The time for filing an appeal was available as on that date
3. An appeal in respect of such order has been filed within the stipulated time, without making any application for condonation of delay

To resolve the aforementioned issue, the Central Government ordered that such appeals will be treated as pending as of 22 July 2024, and the person filing the appeal will be considered an appellant under the scheme. The disputed tax will be calculated based on the appeal, and the provisions of the scheme will apply accordingly.

Special provisions regarding operation of cruise ships by non-residents – New rule introduced

The CBDT *vide* Notification No. G.S.R. 67(E) on 21 January 2025 has amended the Income Tax Rules, 1962. A new Rule 6BG has been introduced after 6GA, which deals with special provisions for computing profits and gains of non-residents engaged in the business of operating cruise ships under Section 44BBC. The new rule outlines the conditions for such non-residents *viz.*, operating passenger ships with a carrying capacity of over 200 passengers or 75 meters in length, for leisure and recreational purposes, primarily for passenger transport and not for carrying cargo, on scheduled voyages or shore excursions to at least two sea ports in India and operates as per the procedures and guidelines issued by the Ministry of Tourism or Ministry of Shipping.

Venture Capital Funds and Finance Companies in IFSCs – New conditions in Income Tax Rules

The CBDT *vide* Notification No. G.S.R. 76(E) has amended the Income-tax Rules, 1962, through the Income-tax (Second Amendment) Rules, 2025. These amendments address conditions for Venture Capital Funds and Finance Companies located in International Financial Services Centres (IFSC). Key changes include:

1. Venture Capital Funds referred to in Regulation 18(2) of the IFSC Authority (Fund Management) Regulations, 2022, will now be categorized as Category I Alternative Investment Funds under IFSC regulations for the purpose of Section 10(23FB).
2. For the purpose for exemption from applicability of thin capitalisation, Finance Companies located in IFSCs can only engage in activities like -
   - Lending-related activities, such as loans, commitments, guarantees, credit enhancement, securitization, and financial leasing
   - Factoring and forfeiting of receivables
   - Global or Regional Corporate Treasury functions, including borrowing, lending, hedging, cash management, intra-group financing, structured credit, financial budgeting and similar other such treasury services and activities.

   The interest paid by such Companies to a non-resident borrower in respect of a debt, shall be in foreign currency.
3. New conditions are set for retail schemes and Exchange Traded Funds (regulated under the IFSCA Fund Management Regulations 2022), including investment restrictions and listing requirements on recognized stock exchanges.

Principal Purpose Test in India's DTAAs – Guidance

The Ministry of Finance, through the Central Board of Direct Taxes has issued Circular No. 01/2025 on 21 January 2025 to provide guidance on the application of the Principal Purpose Test ('**PPT**') under India's Double Taxation Avoidance Agreements ('**DTAAs**'). This is in light of the Multilateral Convention to Implement Tax Treaty Related Provisions to

Prevent Base Erosion and Profit Shifting ('**MLI**'), which came into force for India on 1 October 2019.

The circular explains that the PPT applies prospectively, based on the date the DTAA or the amending protocol came into force where the clause relating to PPT was incorporated through bilateral negotiations.

For treaties modified *via* the MLI, the PPT applies to withholding taxes from the first day of the year after the last of the dates MLI enters into force for the contracting jurisdictions to the concerned treaty. For other taxes, it applies from the year starting six months after the last of the dates MLI enters into force for the contracting jurisdictions to the concerned treaty.

The circular also highlights that grandfathering provisions in treaties like India-Cyprus, India-Mauritius, and India-Singapore DTAAs are excluded from applicability of PPT. These provisions are governed by the specific clauses of those treaties and remain unaffected. Additionally, the PPT's application will be assessed on a case-by-case basis, with reference to international guidelines like the BEPS Action Plan and UN Model Tax Convention.

Ratio Decidendi

- Exemption under Section 10A to new unit – New and identifiable undertaking separate and distinct from existing business should come into existence – *Delhi High Court*
- Refund of excess TDS deduction – CBDT Circular No. 07/2007, prescribing limitation period for refund, construed as ultra vires – *Delhi High Court*
- Expenditure deduction allowed to a law firm making payment of licence fee for utilization of goodwill – *Delhi High Court*
- Secondment of employees – Determining Permanent Establishment under India-South Korea DTAA – *Delhi High Court*
- Applicability of Section 92BA for Transfer Pricing in regard to domestic transactions with eligible units u/s 80-IA – *ITAT Hyderabad*

Exemption under Section 10A to new unit – New and identifiable undertaking separate and distinct from existing business should come into existence

The Assessee was carrying on functions through an expert oriented unit which commenced its business on 1 June 1995. The said unit was availing exemption under Section 10B of the Income Tax Act, 1961 ('**IT Act**') from AY 1996-97. The Assessee applied for setting up a new unit under the Software Technology Park ('**STP**') Scheme on 10 January 2002 and in pursuance of the same, established an STP unit and claimed exemption u/s 10A of the IT Act. The unit was engaged in operating a call centre and performing other back office and support centre services. The Department rejected the Assessee's claim for exemption on the premise that the STP unit was merely a splitting up of the existing export-oriented unit which was already availing the benefits u/s 10B of the IT Act.

On Appeal, the CIT (A) and ITAT held that since the nature of activities undertaken by the export-oriented unit and the STP are different and that separate licence and infrastructure have been obtained and created for the new unit, both companies have to be treated differently. It was further held that since fresh funds have been invested in the new unit and that even after setting up the new unit, the turnover of the old unit had not reduced, the exemption claimed by the Assessee u/s 10A should be allowed.

Aggrieved by the same, the Department filed an appeal before the Delhi High Court. The Department contended that Section 10A(2)(ii) of the IT Act provides that exemption can be claimed only if an undertaking is not formed by splitting up, or the reconstruction of a business already in existence and considering that in the present case, the STP unit was formed by merely splitting up the existing business of the export oriented unit, exemption u/s 10A must be denied.

The High Court placed reliance on the decision of the Supreme Court in *CIT* v. *Sociedade De Fomento Industrial Pvt. Ltd.* [(2022) 443 ITR 34] wherein tests were laid down to ascertain whether an Assessee can claim exemption under Section 10B of the IT Act. The relevant factors are as follows-

(1) The fact that an assessee by establishment of a new industrial undertaking expands his existing business, which he certainly does would not on that score, deprive him of the benefit. Every new creation in business is some kind of expansion and advancement.

(2) The true test is not whether the new industrial undertaking connotes expansion of the existing business

of the assessee but whether it is all the same a new and identifiable undertaking separate and distinct from the existing business

(3) In order that the new undertaking can be said to be not formed out of the already existing business, there must be emergence of a physically separate industrial unit which may exist on its own as a viable unit.

(4) The products produced by the new unit may be consumed by the assessee in his old business or may be sold in the open market. One thing is certain that the new undertaking must be an integrated unit by itself wherein articles are produced

Placing reliance on the aforesaid factors, the Hon'ble High Court held that true test would not be whether the expansion of an existing business amounts to an expansion *per se*, rather it should be that a new and identifiable undertaking separate and distinct from the existing business should come into existence. Thus, the High Court upheld the Order of the ITAT with respect to the nature of activities undertaken by the STP unit being distinct from the export-oriented unit and allowed the claim of exemption of the Assessee u/s 10A of the IT Act. [*CIT v. American Express India Pvt. Ltd.* – TS 83 HC 2025 (DEL)]

Refund of excess TDS deduction – CBDT Circular No. 07/2007, prescribing limitation period for refund, construed as *ultra vires*

Ranbaxy Laboratories ('**RLL**'), a company engaged in the business of research, manufacture and trading of drugs and pharmaceuticals, issued an Offering Circular to various interested investors inviting investment in Foreign Currency Convertible Bonds. The bonds could be convertible at any time and the conversion was envisaged to result in holders acquiring fully paid-up equity shares in RLL. The said bonds were floated by RLL for the purposes of equity infusion in its wholly owned subsidiary Ranbaxy Netherlands BV and for expansion of its global business operations.

The said Netherlands company acted as a holding company of Terapia SA, a company based in Romania. For funding its global business operations, the Netherlands company availed the loan facilities extended by three different banks. As per the stipulations of various loan facility agreements, RLL paid premium / interest to various bond holders and banks during FY 2010-11 to 2012-13 without making any deductions towards tax. It deposited the entire premium and interest after grossing up u/s 195 of the IT Act and thus bore the burden of taxes withheld. In essence, the remittances to bond holders and banks were not subjected to deduction of tax, but RLL, out of abundant caution, deposited the tax deducted on the premium and interest paid in exercise of its perceived obligations u/s 195 of the IT Act. Further, the interest and premium expenditure incurred by the Assessee were claimed as deduction under Section 36(1)(iii) of the IT Act

Having realized that there was no necessity to deduct tax u/s 195 of the IT Act, RLL filed revised TDS returns on 29 March 2014 and claimed refund of the tax deposited w.r.t the payments of premium and interest on the bonds that it obtained. This was followed by the filing of a formal application on 31 March 2014 with the Assessing Officer ('**AO**') seeking refund of the excess tax deposited. On 24 March 2015, RLL merged with Sun Pharmaceutical Industries ('**Assessee**') in terms of a scheme of arrangement w.e.f 1 April 2014. The said refund applications were rejected *vide* Order dated 27 March 2018 on two counts-

- As per Para 9 of the CBDT Circular No. 07/2007 (the Circular has been issued in exercise of the powers conferred on CBDT *vide* Section 119 of the IT Act) which provides that limitation for making a claim of refund shall be 2 years from the end of the FY in which tax was deducted at source, the application made by the Assessee beyond the said time limit holds no water and thus, cannot be granted.
- The investments and utilization of funds were not in relation to the business of the Assessee and thus, the expenses incurred by the Assessee w.r.t payment of interest ought to be disallowed.

Aggrieved by the same, the Assessee preferred a writ petition before the Delhi High Court. It was submitted by the Assessee that Section 200(3) of the IT Act provides that any person deducting shall after paying the tax deducted prepare such statements as may be prescribed and deliver the same to the prescribed authority. It was further submitted that the first proviso to Section 200 of the IT Act only provides for filing of a corrected statement (a statement that is required to be filed by an Assessee if excess deduction of tax has been made with respect to any transaction) to the prescribed authority and that it does not prescribe any time limit within which an application to claim refund excess of the tax deposited is to be made.

The Assessee further, placed reliance on the decisions of the Delhi High Court in *Vikram Singh* v. *Union of India* [(2017) 394 ITR 746], Bombay High Court in *Sofitel Realty LLP* v. *ITO* [2023 SCC OnLine Bom 1498] and *Footcandles Film Pvt Ltd* v. *ITO* [2022 SCC OnLine Bom 11768] to substantiate that CBDT Circulars, being subordinate to the principal Act / rules, cannot override or restrict the application of specific provision enacted by the Legislature. Taking the aforesaid submissions into account, the High Court held that the limitation period as prescribed in Paragraph 9 of the Circular could not have imposed impediments upon the sustainability of the Assessee's application for refund and held that Paragraph 9 of the said Circular was *ultra vires*.

Further, with respect to the issue of disallowance of expenditure, the Assessee submitted that no part of the investments made leading up to the placement of funds in the hands of RLL or external commercial borrowings were routed through India or utilized in connection with the operations of RLL in India. Thus, the interest paid by RLL was for the purposes of a business undertaken outside India as well as for the purposes of making or earning income from a source outside India. Since those funds and investments are utilized to shore up the financials of the subsidiary company of the Netherlands company, which is a holding company of Terapia, the payment of interest would fall with the scope of exception (b) carved out of Section 9(1)(v) i.e., interest payable with respect of any debt incurred for the purposes of a business or profession carried on by such person outside India or for the purpose of making or earning income from any source outside India, such interest shall not be deemed to be income accruing / arising in India. Thus, the said expenditure cannot be disallowed.

The High Court placed reliance on the decision of the Supreme Court in *S.A. Builders* v. *CIT* [(2007) 1 SCC 781] wherein the principle of commercial expediency was enunciated. It was therein held that that any expenditure incurred by a person as a prudent businessman would qualify for deduction. In the present case, the High Court held that for the purposes of claiming deduction, there is no necessity that the Assessee be under a legal obligation. It was further held that since the revenues generated from the issuance of foreign currency convertible bonds as well as the external commercial borrowings were utilized exclusively for the benefits of the Netherlands company, the liability so taken over by the Assessee would thus clearly fall within the ambit of a debt incurred as well as moneys borrowed, used for the purposes of making or earning income from a source outside India.

Following *S.A. Builders* as stated supra, the High Court thus held that considering that the Assessee has an enduring interest in the business prospects of the related entity, any liabilities undertaken by the Assessee for Terapia SA would be a commercial expediency and therefore allowed the expenditure incurred by the Assessee. [*Sun Pharmaceuticals Ltd.* v. *ITO* – TS 69 HC 2025 (DEL)]

Expenditure deduction allowed to a law firm making payment of licence fee for utilization of goodwill

A sole proprietorship was established under the name 'Grant & Remfry' which was then converted into a partnership firm called 'Remfry & Sons' and the entire business was acquired by Dr. Sagar w.e.f 01.04.1973 alongwith the goodwill earned by the firm over the years. The name of the firm was subsequently changed to 'Remfry & Sagar'. Thereafter Dr. Sagar gifted the goodwill vesting in 'Remfry & Sagar' to a private limited company, Remfry & Sagar Consultants Pvt. Ltd. ('**RSCPL**') by way of a registered instrument. The shareholding of RSCPL was substantially held by Dr. Sagar's children who were not legal practitioners. Dr. Sagar then entered into a partnership with individual partners who were practicing in the field of law.

The said partnership deed was followed by the execution of an instrument titled 'Licence of the use of goodwill' between RSCPL and the individual partners. Dr. Sagar, who was carrying on the practice and profession of attorneys-at-law under the name 'Remfry & Sagar', had goodwill in the name of 'Remfry & Sagar' and all the rights associated herewith (including intellectual property) belong exclusively to him. Vide the said licence agreement, the said partners were permitted to use the name 'Remfry & Sagar' in carrying on of the continued practice'. In consideration of the same, the partners shall pay RSCPL a sum calculated at the rate of 25% of the amount of bills raised by the said partnership. In furtherance, RSCPL shall make available to the partners the use of secretarial, accounting and other supporting services for the purpose of carrying on of the continued practice and also make available the use of infrastructure associated with the said practice.

In pursuance, the said partnership was constituted under the name 'Remfry and Sagar' ('**Assessee**') which made payment of licence fee for use of the goodwill as well as utilization of infrastructure and support services, and claimed deduction under Section 37 of the IT Act. The AO denied the deduction on the ground that the same is a colorable transaction aimed at diversion of funds for the personal benefit of the children of Dr. Sagar. On Appeal, the CIT (A) held that since receipts representing licence fee were already taxed in the hands of RSCPL, deduction ought to be allowed u/s 37 of the IT Act. On Appeal, the ITAT upheld the view of the CIT(A) by holding that the arrangement was not for avoidance of tax and diversion of profits. The Tribunal further went on to hold that since the Assessee firm could not have used the name and style of 'Remfry & Sagar' without seeking permission and licence from Dr. Sagar, the said payment is to be held as incurred wholly and exclusively for business and profession.

Before the Hon'ble High Court, the Department placed reference on Explanation 1 to Section 37(1) which provides that any expenditure incurred by an Assessee for any offence prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and that no deduction shall be allowed with respect to such expenditure. The Department submitted that as per Chapter 3 of the Bar Council of India Rules, it is provided that an Advocate shall not enter into a partnership or any other arrangement for sharing remuneration with any person or legal practitioner who is not an Advocate. In view that the condition contained in Chapter 3 is a prohibition introduced by law, the said licence fee shall not be allowed as an expenditure referred to in Section 37 of the IT Act.

The Department placed reliance on the decision of the Hon'ble Supreme Court in *Apex Laboratories Pvt. Ltd.* v. *DCIT* [(2022) 7 SCC 98] wherein the SC had held that expenditure incurred towards provision of extravagant amenities and freebies to medical practitioners cannot be claimed as a business expenses as per explanation 1 to Section 37(1) of the IT Act since a medical practitioner was prohibited by law to receive such gifts as per the regulations framed by the Medical Council of India.

The Assessee submitted that Explanation 1 to Section 37 prohibits only those expenditures which may have been incurred for the purposes of commission of an offense or an action prohibited by law. Emphasis was placed on the term 'purpose' to be read as expenditure incurred for a purpose which is prohibited by law. The Assessee submitted that in the given case, the remuneration which was paid to RSCPL was in lieu of the grant of license to utilize the goodwill represented by the name 'Remfry & Sagar'. Therefore, considering the primary purpose of payment of licence fee, the Assessee contended that it cannot be construed as being an expenditure prohibited by law. The Department has wrongly interpreted the provisions of the licence agreement as embodying an intent of sharing of remuneration with RSCPL.

The High Court upheld in favour of the Assessee by observing that the principal purpose test must be applied to determine whether an expenditure can be disallowed. The Court held that a breach of the Bar Council of India rules is not classified as an offence.

The Court held that in the given case on hand, a payment for use of goodwill cannot be viewed as an illegal purpose. Remfry & Sagar had acquired a reputation and goodwill in the field of legal services and the Assessee thus sought to derive advantage and benefit of association as also the use of a name which carried a reputation in the legal arena. The High Court further distinguished the reliance placed by the Department on *Apex Laboratories* case stating that the Regulation violated therein pertained to receiving gifts, travel expenses, hospitality or other monetary grants which were prohibited as per the Medical Council Regulations, however, in the given case, the resultant firm only tried to derive benefit from the goodwill generated in the name 'Remfry and Sagar' and therefore any consideration paid for the use of such name, cannot be said to be for an unlawful purpose or one motivated by the intent to overcome prohibition raised by law. [*PCIT* v. *Remfry & Sagar* – TS 73 HC 2025 (DEL)]

Secondment of employees – Determining Permanent Establishment under India-South Korea DTAA

The Assessee, a tax resident of South Korea, had two wholly owned subsidiaries in India, Samsung India Electronics Private Limited ('**SIEL**') and Samsung India Software Operations Private Limited ('**Samsung R&D**'). A survey on SIEL's premises led to notices under Section 148 for six assessment years, from 2004-05 to 2009-10. AO held that the premises of SIEL constitute a Fixed Place Permanent Establishment ('**PE**') as per Article 5 of the India-Korea Double Taxation Avoidance Agreement ('**DTAA**'). It was further held that SIEL also met the tests of a Dependent Agent PE and Service PE, and shall anyways be considered as a PE of the Assessee, by virtue of being its subsidiary *per se*.

Dispute Resolution Panel (DRP), on an appeal, set aside the conclusions of the AO with respect to SIEL being considered as a PE, merely by virtue of being a subsidiary. However, the DRP concluded that the secondment of employees resulted in a deemed PE, which was based on the statements of expatriate employees seconded to SIEL. However, the Tribunal disagreed with the DRP and found that the seconded employees were posted to India under a tripartite agreement and were not performing activities connected with the global business of Samsung Korea. The Tribunal concluded that the seconded employees were engaged for the benefit of SIEL, not the parent company's business. The Delhi High Court, citing the principles from *Progress Rail Locomotive Inc.* v. *DCIT (International Taxation)*

[(2024) SCC Online Del 4065] and *Hyatt International Southwest Asia Ltd.* v. *CIT* [(2024) SCC Online Del 6546], upheld the Tribunal's view, emphasizing that the secondment of employees, in this case, did not create a PE. It was held that activities like collection of market information and exchange of data did not qualify as establishing a PE.

The High Court also referred to the OECD and UN Model Commentaries, which clarified that the secondment of employees within a multinational group does not necessarily lead to a PE if the activities are for the benefit of the subsidiary. Since the seconded employees were primarily serving the interests of SIEL, the Court ruled that there was no evidence to suggest that their activities were related to generating income for the Korean parent company in India. Thus, the judgment of the Tribunal was upheld, and the appeals were dismissed. [*PCIT* v. *Samsung Electronics Co. Ltd.* – (2025) 170 taxmann.com 417 (Delhi)]

Applicability of Section 92BA for Transfer Pricing in regard to domestic transactions with eligible units u/s 80-IA

The assessee-company is into the business of manufacturing clinker and ordinary Portland cement and also has a power-generating unit eligible for deduction under Section 80-IA. The assessee entered into specified domestic transactions of supplying power from the power-generating unit to the cement manufacturing unit. However, the assessee did not claim deduction under Section 80-IA for the year under consideration.

The Assessee has adopted the rate of tariff by Gujarat State Electricity Board (GSEB) as the comparable uncontrolled price for benchmarking the specified domestic transaction. The case has been referred to the Transfer Pricing Officer (TPO), by the AO to determine the Arm's Length Price (ALP) for the said specified domestic transactions.

The TPO made adjustments based on the Arm's Length Price under Section 92CA(3) by applying the Most Appropriate Method (CUP Method) and rejected the GSEB rates as an appropriate comparable for determining the Arm's Length Price. The objections raised by the assessee upon receipt of the draft assessment order were dismissed by the Dispute Resolution Panel (DRP). The assessee contended that since it was a loss-making company and had not claimed the deduction under Section 80-IA, as it ceased to be eligible for the deduction and, consequently, Section 92BA will not apply.

The ITAT, Hyderabad held that the provisions of Section 92BA are applicable when the transactions are specified domestic transactions with associates or persons connected with the assessee, even if the assessee does not claim a deduction under Section 80-IA in a given year. The relationship between the power-generating unit and the cement manufacturing unit fell under Section 80-IA(8) and (10), which meant that the transaction was covered by Section 92BA. The Tribunal held that applicability of provisions Section 92BA is not dependent on the claim of deduction u/s 80-IA.

The Tribunal observed that the transaction was structured in such a way that it shifted profits from a non-eligible unit to an eligible unit, which invoked the application of these sections.

The Tribunal held that the TPO rightly benchmarked the transaction using internal comparables, i.e., the electricity sold to 14 consumers by the assessee under a Power Purchase Agreement (PPA). It was found that the rates charged to these 14 consumers were the best comparables, and not the GSEB rates, as the functions and risks involved in the electricity distribution by GSEB differed from those of the assessee. The Tribunal dismissed the appeal of the assessee, confirming the TPO's adjustments and rejecting the argument that GSEB's tariff rate should be used for benchmarking. [*Sanghi Industries Ltd.* v. *DCIT* – (2025) 170 taxmann.com 716 (Hyderabad – Trib.)]

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