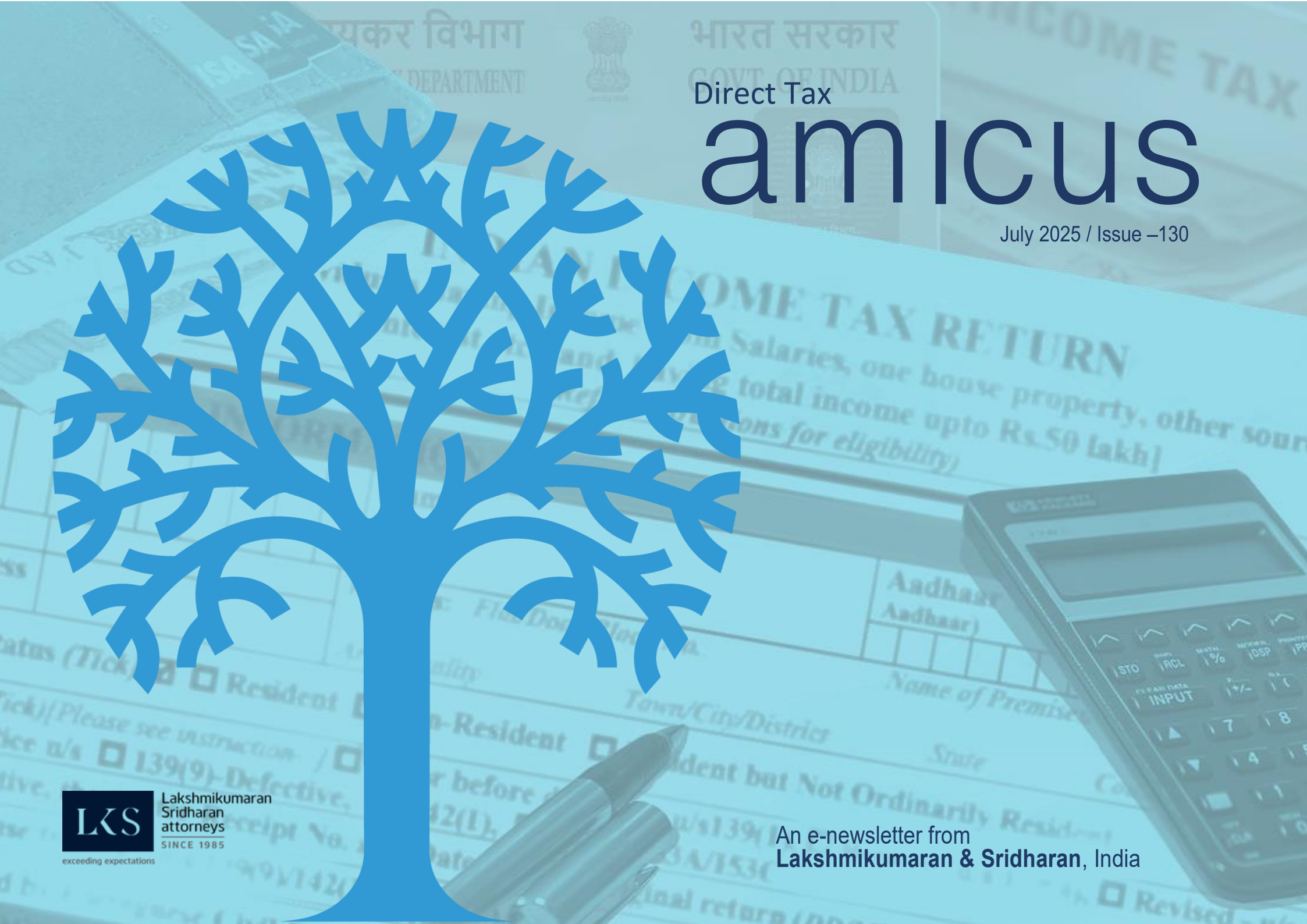
Direct Tax

amicus

July 2025 / Issue –130



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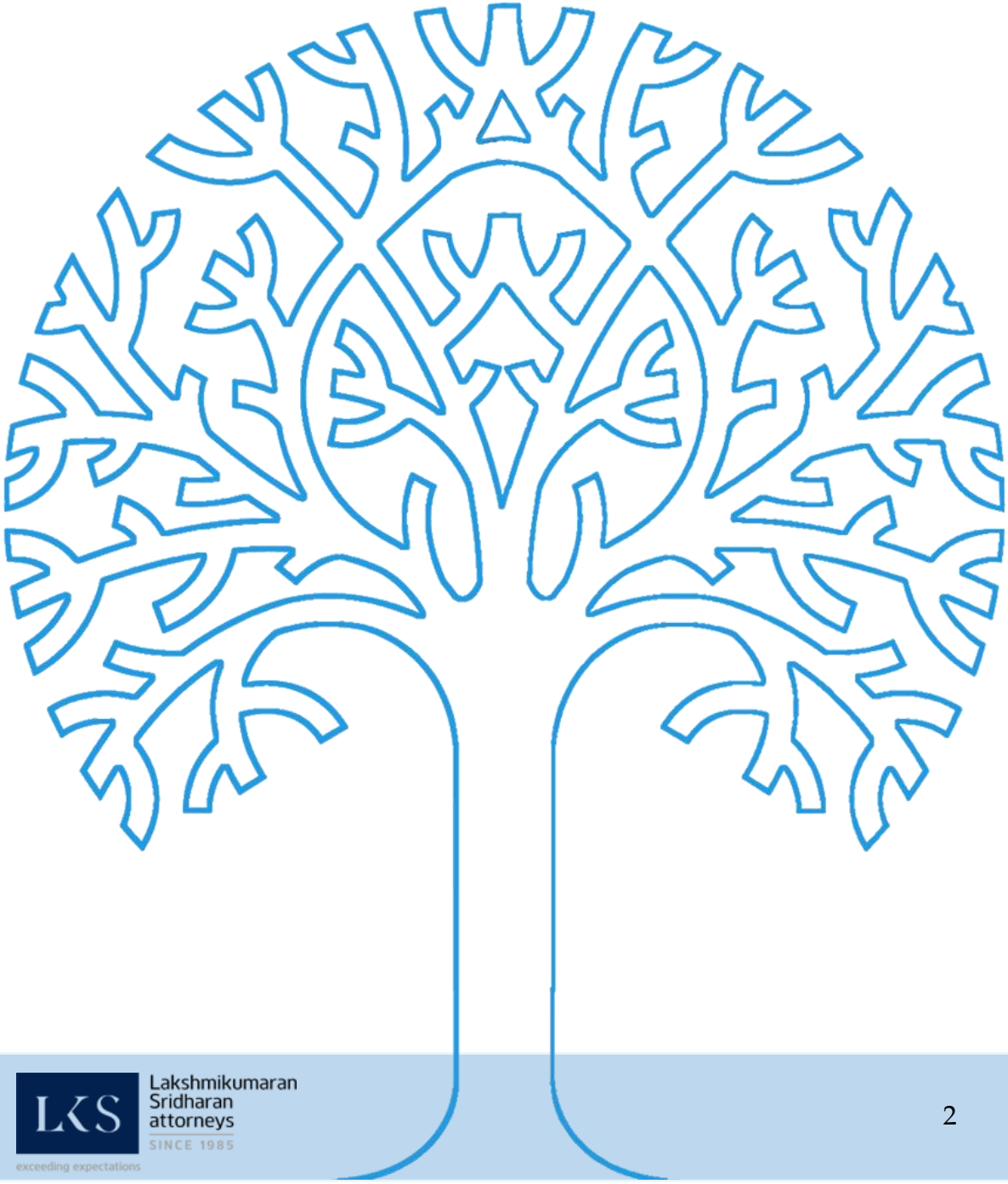

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Article

Modern agriculture rooted in traditional Income-tax law

By **Harshit Khurana, Sonali Bansal and Rishabh Bhatia**

While agricultural operations have been modernised, the law for claiming income-tax exemption for agricultural operations has remained constant. The key question which arises in such a situation is how the age-old income-tax exemption apply to modern agriculture. The article in this issue of the newsletter focuses on various aspects of the textbook provisions, their implications on the modern agriculture and the take of Indian judiciary on the same. The authors, for this purpose, delve deeply on questions like what constitutes 'land' for agriculture, while also pondering over the question of exemption to income from sale of agricultural produce in cases involving contract farming. According to the authors, all agricultural activities as understood in normal parlance may not be eligible for the benefit of the exemption and thus navigating agricultural tax exemptions requires a deep understanding of various discussed nuances.

Modern agriculture rooted in traditional Income-tax law

By Harshit Khurana, Sonali Bansal and Rishabh Bhatia.

Introduction

India is often referred to as country of farmers. Agriculture activity forms a vital part of Indian economy. For decades, while the Governments may have changed but the focus on benefitting this sector has remained steadfast.

One such form of unwavering support has been in the form of income-tax exemption[1] granted to this sector which has been there for decades.

Over a period of time, the way of undertaking agricultural activities has transitioned significantly. Modern techniques such as vertical farming have been introduced wherein agricultural produce is grown indoors in vertically stacked layers. Also, it is quite common for the landowners and farmers to have a collaborative arrangement for undertaking farming.

While agricultural operations have been modernised, the law for claiming income-tax exemption for agricultural operations has remained constant. The key question which arises in such a situation is how the age-old income-tax exemption apply to modern agriculture.

This article focuses on the various aspects of the textbook provisions and their implications on the modern agriculture and the take of Indian judiciary on the same.

What constitutes 'land' for agriculture: A fixed place with soil or any place with soil?

Under the Income-tax law, any income derived from 'land' by agriculture has been exempted. Also, any income derived from saplings or seedlings grown in a nursery has been deemed to be agricultural income.

In the traditional sense, land is construed as an immovable property where activities in the nature of tilling of soil, sowing of seeds and plantation activity can be undertaken. However, agriculture has moved far beyond its traditionally understood scope. Now, agriculture activities are being undertaken in factories, greenhouses and nurseries. The scope has expanded to customised produce with increased nutritional value.

[1] Sectio 10(1) read with section 2(1A)

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The ITAT Hyderabad (Special Bench) in the case of *Inventaa*[2] gave a wider interpretation to the exemption provided under the law. The Tribunal observed that soil is part of land and when such soil is placed in trays, it does not cease to be land and when operations are carried out on this 'soil', it will qualify as agricultural activity carried upon the land itself. The Special Bench also held that the nature of produce cannot be restricted to exclude white button mushrooms. Any product raised on land/ soil by performing basic functions will qualify for exemption. Lastly, the Special Bench also affirmed the position that advancement of technology which allows taxpayers to grow produce in controlled environment will not negate their claim of exemption.

However, in a recent judgement, the Madras High Court in the case of *British Agro Products India (Private) Limited*[3] dealt with the question of what constitutes 'land' for the purpose of taxation of agricultural income under the Income-tax law. The High Court held that that white button mushrooms harvested in the controlled environment in a factory will not be eligible to tax exemptions. The Court held that the button mushrooms were not cultured in the land used for agriculture purposes and therefore, it is taxable under the IT Act.

The Court distinguished from the judgement of Special Bench on facts. The High Court stated the Special Bench of the Tribunal did not examine the issue from the point of view of definition of 'agricultural income' under Section 2(1A) of the Income-tax Act, 1961.

It is worthwhile to note that the ITAT (Special Bench) in its judgment had undertaken detailed analysis of the judicial precedents and by applying the principle of purposive interpretation it had concluded upon the matter. The Madras High Court has not provided adequate reasoning for diverting from the view expressed by the ITAT. Also, the High Court did not deal with the intent of introducing the exemption as reflected in the Finance Minister's speech and the memorandum while extending the benefit of agricultural exemption to saplings or seedlings grown in a nursery.

Considering the advancement in agricultural operations, the judgment is likely to have mass effect. One will have to wait and watch if the matter is challenged before the Supreme Court. In Author's view, in cases where it can be explained that all

[2] [2018] 95 taxmann.com 162 (Hyderabad-Trib.); Appeal pending before Telangana High Court I.T.A. Nos. 58, 70, 74 and 100 of 2019

[3] [TS-641-HC-2025(MAD)]

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basic operations such as tilling of land, sowing of the seeds, planting and similar operations, as laid by Hon'ble Supreme Court in the case of *Raja Benoy Kumar Sahas Roy*[4] are carried out from the factory, it can be good case to argue that agriculture exemption should be available to the taxpayers.

Contract farming vs. hiring of farmers on contract basis

Unlike a decade ago, there are many companies which undertake agricultural activities by engaging contract farmers or agents. The question which stems in these cases is whether the income from sale of agricultural produce will qualify for income-tax exemption.

The Courts/ Tribunals in India have adjudicated these fact situations on numerous occasions. The key judgments have been discussed in the form of case studies to understand the legal position emanating on the issue.

> ***Case Study 1*:** XYZ Pvt. Ltd. entered into an agreement with the farmers for cultivation of hybrid seeds on the lands owned by the farmers only. XYZ Pvt. Ltd. supplied the foundation seeds, and the farmers performed all activities under the guidance, specifications and supervision of the company on the land earmarked as per the agreement. The farmers were responsible to observe all the conditions regarding cultivation and other incidental matters. The farmers received compensation at a fixed price per quintal for the approved quality of seeds.

The Karnataka Hight Court held that the income arising from sale of hybrid seeds would not be agriculture income in the hands of assessee-company. The High Court noted that the Company neither had any interest in the land nor actually cultivated the land. Also, all the necessary activities of agriculture were carried out by the farmers. Mere supervision of those activities by the assessee-company will not qualify as carrying out of agricultural operations. Further, the Court also noted that the consideration which was paid to the farmers was fixed and depended upon the quality of the seeds. This demonstrated that the Company was interested only in healthy seeds grown by the farmers and not entire produce.

[4] [1957] 32 ITR 466 (SC)

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[refer *CIT* v. *Namdhari Seeds (P.) Ltd.* – [2011] 16 taxmann.com 83 (Kar), SLP admitted]

***Case Study 2*:** XYZ Pvt. Ltd. entered into lease and service agreement with the farmers for leasing of land owned by farmers and cultivation of seeds on said land by obtaining the services of farmers. XYZ Pvt. Ltd supplied parent seeds to the farmers free of cost for cultivation under the supervision of the company. The farmers received compensation at a fixed rate based on the procurement of seeds by the company which was then bifurcated into land lease rent, fertilizers & chemicals and labour & service charges. The responsibility to carry out basic operations was that of the farmers.

The Tribunal, in this case, placed reliance on the judgement given by the Karnataka High Court in the case of *CIT* v. *Namdhari Seeds (P.) Ltd.* (*supra*) and held that the income arising from such arrangement will qualify business income and is not eligible for exemption. This decision was based on the fact that farmers were not employees of the assessee and the assessee's role was limited to supervision without directly carrying out any basic operation for cultivation of land.

[refer *P.H.I. Seeds (P.) Ltd* v. *DCIT* – [2018] 96 taxmann.com 493 (Delhi - Trib.)]

Case study 3: XYZ Pvt. Ltd. was engaged in the development and production of basic and hybrid seeds. The Company undertook the primary operations on its own or leased land, under its own direct supervision and guidance with the help of casual labour. The company thereupon cleaned the hybrid seeds i.e removed the mud, stones and non-standard sized seeds and then treated the seeds with chemicals to prevent infestation, packed the seeds into cloth bags to suit market requirements and dispatched the seeds to consignee's agents located all over the country for sale to the distributors.

The Tribunal distinguished from the case of *Namdhari Seeds (P.) Ltd*. (*supra*) on facts and ruled in favour of the assessee-company. The Tribunal took of the facts that (i) the company undertook the activity of producing the basic seeds on its own lands and hybrid seeds on the leased lands, (ii) the company engaged the services of the farmers for production of hybrid seeds, and (iii) the

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company took the entire produce from the farmers and reimbursed entire expenditure to them. The entire control over the production rested with the company.

[*Advanta India Ltd.* v. *ACIT* – [2013] 34 taxmann.com 188 (Bangalore-Trib.)]

The principles emanating from the above judgments have been applied in other cases by the Courts/ Tribunals.

Final thoughts

From the above discussion, it is to be noted that all agricultural activities as understood in normal parlance may not be eligible for the benefit of the exemption. It needs to be substantiated that the taxpayer has certain interest in the land on which the activities are undertaken. Also, basic agricultural operations must be carried out under the control of the taxpayer. Merely supervising the activities may not be sufficient. Active participation and decision-making in the core farming processes are crucial.

Also, while innovative farming methods are transforming industry, their eligibility for tax exemption remains a contentious point. There exist arguments to support the claim of the taxpayers, however, the strength of the same may vary depending on the factual matrix of each case.

In essence, navigating agricultural tax exemptions requires a deep understanding of these nuances. It's not just about the crops you grow, but how you grow them and your connection to the land.

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Notifications & Circulars

- Time limit for processing returns of income filed electronically u/s 119(2)(b) of the Income Tax Act, 1961 extended
- Interest waiver when TDS/TCS payment initiated but tax not credited to Government before the due date – CBDT Circular dated 28 March 2025 clarified
- No tax deduction at source on certain payments made to an IFSC Unit
- Effect given to protocol amending India-Oman DTAA
- Cost Inflation Index for AY 2026-27 notified

Time limit for processing returns of income filed electronically u/s 119(2)(b) of the Income Tax Act, 1961 extended

CBDT had issued Circular No.09/2015 *vide* F.No.312/22/2015-OT dated 9 June 2015, Circular No.07 /2023 *vide* F.No.312/63/2023-OT dated 31 May 2023 and Circular No.11/2024 dated 1 October 2024, dealing with applications for condonation of delay in filing of returns claiming refund and returns claiming carry forward of loss and set off by the Income Tax Authorities. The aforesaid returns could not be processed within the prescribed time limit provided under second proviso to Section 143(1) of the IT Act due to some technical reasons.

Accordingly, *vide* Circular 07/2025 dated 25 June 2025, the time limit provided under the IT Act to process returns of income has been relaxed for the valid returns of income filed electronically on or before 31 March 2024, pursuant to an order passed by a competent authority u/s 119(2)(b) of the IT Act. In such cases, intimation under Section 143(1) of the IT Act shall be sent to the assessees by 31 March 2026.

The said circular provides that the relaxation shall not be applicable to assessment under Section 143(3)/144/144B/153A/153C of the IT Act or reassessment under Section 147/148 of the IT Act or re-computation or revision of income under the Income Tax Act.

Interest waiver when TDS/TCS payment initiated but tax not credited to Government before the due date – CBDT Circular dated 28 March 2025 clarified

CBDT *vide* Circular No. 5/2025 dated 28 March 2025 ('**Circular**') provided for reduction or waiver of interest charged under Section 201(1A)(ii) or 206C(7) of the IT Act in cases where:

i. the payment of TDS or TCS to the Central Government is initiated by the taxpayers/ deductors/collectors and the amounts are debited from their bank accounts on or before the due date, and

ii. the tax could not be credited to the Central Government, before the due date because of technical problems, beyond the control of the taxpayer/ deductor / collector.

In light of the above, CBDT has clarified the following *vide* Circular No. 8/2025 dated 1 July 2025:

i. The prescribed authority (i.e., CCIT/ DGIT/ Pr. CCIT) is empowered to pass the order for waiver of interest after the date of issuance of the Circular.

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ii. Applications for the waiver of interest can be entertained within one year from the end of the financial year for which the interest is charged

iii. Waiver applications can be entertained for interest charged even before the issuance of the Circular, subject to the time limit of one year as provided above.

No tax deduction at source on certain payments made to an IFSC Unit

Section 80LA(1A) of the IT Act provides that an IFSC Unit shall be allowed a deduction of an amount equal to a hundred percent of its income falling under sub-section (2) for any ten consecutive assessment years, at the option of the assessee, out of fifteen years, beginning with the AY in which it was registered.

Further, Section 197(1F) provides that the Central Government has the power to notify that certain payments made to a person or class of persons, including institution, association or body or class of institutions, associations or bodies is exempt from deduction of tax under the IT Act.

In the light of the above provisions, the CBDT *vide* Notification No. S.O. 2768(E) dated 20 June 2025 has notified a list of payments made to certain IFSC units defined under the said notification that shall not be subject to TDS provisions. The same are specified below:

- Professional or Consulting or Advisory fees u/s 194J paid to BATF Service Provider
- Payment made by Recognised Stock Exchanges u/s 194J and Commission Incentives u/s 194H/194C paid to Broker Dealers
- Interest on account of lease u/s 194A and Freight Charges or Hire Charges u/s 194C paid to Finance Company
- Portfolio management fees, Investment advisory fees, Management fees and Performance fees u/s 194J paid to Fund Management Entity
- Professional or Technical Services fees, Penalty levied on clearing members u/s 194J and Interest Income u/s 194A paid to Recognised Clearing Corporation
- Professional or Technical or Contractual fees u/s 194J/194C paid to Recognised Depository
- Professional or Technical Services fees, Penalty levied on Members by Stock Exchanges u/s 194J, Rent for Data Centres u/s 194I and Interest Income u/s 194A paid to Recognised Stock Exchange

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The relaxation provided shall be subject to the following conditions:

(i) The payee shall furnish and verify a statement-cum-declaration in Form No. 1 to the payer, for each previous years relevant to the ten consecutive assessment years for which the payee opts for claiming deduction under sub-sections (1A) and (2) of Section 80LA of the IT Act

(ii) the payer shall not deduct tax on payment made or credited to the payee, after the date of receipt of copy of statement- cum declaration and also furnish the particulars of all the payments made to the payee on which tax has not been deducted in its statement under Section 200(3) of the IT Act.

Effect given to protocol amending India-Oman DTAA

A protocol amending the double taxation avoidance agreement ('**DTAA**') between the Republic of India and the Sultanate of Oman was signed on 27 January 2025 and entered into force on 28 May 025. Now, in exercise of powers under Section 90(1) of the Income Tax Act, 1961, the Central Government has notified the protocol amending the India-Oman tax treaty *vide* Notification No. S.O. 2858(E) dated 25 June 2025.

The amendments proposed in the Protocol shall have effect for income derived in the FY 2026-27 in India [Article 15(3) of the protocol. Accordingly for withholding tax purposes, the amendment shall have effect from 1 April 2026.

In the protocol, changes have been made in the Preamble, Article 2 (Taxes Covered), Article 3 (General Definitions), Article 4 (Resident), Article 8 (Air Transport), Article 10 (Associated Enterprise), Article 13 (Royalties), Article 14 (Technical Fees), Article 25 (Avoidance of Double Taxation), Article 26 (Mutual Agreement Procedure), Article 27 (Exchange of Information) of the India-Oman Double Taxation Avoidance Agreement.

Further, new Articles have been inserted i.e., Article 25A (Non-discrimination), Article 27A (Assistance in the Collection of Taxes) and Article 27B (Entitlement to Benefits). The Protocol signed on 2 April 1997 shall be deleted.

For details of the changes proposed by the Protocol, please refer to our detailed update ***here****.*

Cost Inflation Index for AY 2026-27 notified

Section 48 of the IT Act provides for the computation of capital gains. For computation of long-term capital gains ('**LTCG**'), in certain cases, indexed cost of acquisition and the indexed cost of

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improvement need to be subtracted from the sale consideration to arrive at the capital gains that shall be chargeable to tax.

For computing indexed cost of acquisition/ improvement, the cost of acquisition is proportionately adjusted considering the Cost Inflation Index ('**CII**') in the year of transfer and the CII of the year of purchase or incurring of improvement cost.

The CII for each AY is notified by the Central Government in the Official Gazette. Vide Notification No. S.O. 2954(E) dated 1 July 2025, the CII for AY 2026-27 has been notified at 376.

It is important to note that the CII shall be useful for cases where long-term capital gains are derived by individual/ HUF from transfer of property acquired prior to 23 July 2024. The taxpayers were eagerly waiting for the notification of the CII for discharging their advance tax liability.

For other cases, as the benefit of indexation stands withdrawn, the notification shall not have any implication.

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Ratio Decidendi

- One-time voluntary compensation given for loss of ESOPs qualifies as a capital receipt and is not taxable as a perquisite or a capital gain – *Karnataka High Court*
- Deduction for bad debt shall be allowed on invocation of corporate guarantee given for sister concern as long as the test of commercial expediency is satisfied – *Madras High Court*
- Proportionate deduction to be allowed to company while paying DDT under Section 115-O, if shareholder receiving dividend is exempt under a law that overrides Income Tax Act – *ITAT Mumbai*
- Set-off of business loss of PE allowed against interest income of foreign entity under India-UAE DTAA – *ITAT Mumbai*
- India-UAE DTAA – 'Gross' in Article 11(2) – Loss cannot be equated with expenses – *ITAT Mumbai*
- Loan advanced by one entity to another shall be deemed dividend u/s 2(22)(e) if the assessee is a substantial shareholder in both the entities – *ITAT Mumbai*

One-time voluntary compensation given for loss of ESOPs qualifies as a capital receipt and is not taxable as a perquisite or a capital gain

In this case, the petitioner had received a one-time voluntary compensation from Flipkart Private Ltd, Singapore ('**FPS**') on account of loss of value of ESOPs due to disinvestment in PhonePe by FPS. The petitioner applied for Nil Tax Deduction certificate. The AO rejected the application of the petitioner and contended that this income shall be treated as a perquisite or alternatively, as a capital gain in the hands of the assessee.

The Karnataka High Court held in favour of the petitioner and quashed the order rejecting the application filed by the petitioner seeking issuance of 'Nil Tax Deduction Certificate'. The Court held that the compensation shall be treated as a capital receipt and shall not be taxable as a perquisite or as a capital gain under the provisions of the Income-tax Act, 1961 ('**IT Act**') by relying on various judicial precedents for the following reasons:

(a) TDS cannot be deducted if the payment does not constitute income.

(b) The compensation received does not constitute income but rather it is a capital receipt being one-time voluntary compensation received by the petitioner which does not satisfy taxability in accordance with the charging section.

(c) The one-time voluntary compensatory payment is against fall in value of stock options allotted to the petitioner which is the profit-making structure of the petitioner and therefore, the payment is capital receipt in nature, not exigible to tax.

(d) The amount in question cannot be treated as 'salary' under Section 15 of the IT Act or perquisite under Section 17(2) of the IT Act. Taxability in said section arises only when the option holder exercises its option at which stage market value of the allotted share and the value of stock option is charged as perquisite especially when there is a computational impossibility when there is no allotment of shares.

(e) The charging section and the computation section constitute an integrated code. In the absence of transfer of shares by the petitioner, capital gains taxation cannot arise under Section 45 of the IT Act. Further, the cost of acquisition of stock options by the petitioner cannot be determined and therefore, section 48 of the IT Act cannot be applied.

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(f) The taxability of compensatory payment cannot be brought to tax under any other head of income including 'other sources'.

The High Court followed the Delhi High Court judgement in the case of *Sanjay Baweja* v. *Deputy Commissioner of Income Tax* [(2024) 163 taxmann.com 116 (Delhi)] and dissented with the judgement of Madras High Court in the case of *Nishithkumar Mukeshkumar Mehta* v. *Deputy Commissioner of Income Tax* [TS-582-HC-2024(MAD)].

[*Manjeet Singh Chawla* v. *Deputy Commissioner of TDS* – TS 806 HC 2025 (KAR)]

Deduction for bad debt shall be allowed on invocation of corporate guarantee given for sister concern as long as the test of commercial expediency is satisfied

The assessee was an investment company that held shares in Balaji Distilleries Ltd ('**BDL**') as stock-in-trade. The assessee was also promoter of Balaji Industrial Corporation Ltd ('**BICL**'). The assessee, being a promoter of BICL, gave a corporate guarantee and pledged its shares in BDL with ICICI Bank so that BICL could avail a loan of INR 10 crore. However, BICL was unable to repay the loan and thus according to the loan agreement the Bank recovered the dues by selling the shares of BDL that the assessee had pledged as a guarantee for BICL. Accordingly, BICL owed the market value of the shares as on the date of sale to the assessee. In AY 2009-10, BICL paid an amount of INR 1 crore to the assessee as a full and final settlement for the dues, and the remaining amount was written off in the books of the assessee as bad debt. The assessing officer disallowed this amount, and the order was also confirmed by CIT(A). Before the Income Tax Appellate Tribunal ('**ITAT**'), the orders of the AO and CIT(A) were reversed and subsequently, the Department filed an appeal before the Hon'ble High Court.

It was the contention of the Revenue that the write-off claimed was not wholly and exclusively for business purposes. Rather the amount pertained to a loan availed by BICL and pledging of shares to provide a guarantee for BICL could not be categorized as a business transaction.

The Madras High Court completely disagreed with the reasoning provided by the Revenue and relied on the judgements of *Mahindra and Mahindra Ltd.* v. *Commissioner of Income Tax* [[2023] 151 taxmann.com332 (Bombay)] and *Vaman Prestressing Co. Pvt. Ltd.* v. *ACIT* [[2023] 154 taxmann.com325 (Bombay)] wherein it was observed that whether to treat the

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debt as bad debt or as business loss/deduction is a commercial or business expediency of the assessee based on the relevant material and possession of the assessee. Based on the same, the High Court opined that the decision of the assessee to provide guarantee on behalf of its sister concern affected the assessee's business as well, as it was a shareholder in BICL, and was thus based on commercial expediency of the assessee. Therefore, it was held that the written-off amount was spent wholly and exclusively for the purpose of assessee's business and should be allowed as a deduction under the IT Act.

[*Commissioner of Income Tax, Chennai* v. *Star Investments Pvt. Ltd.* – TS 711 HC 2025(MAD)]

Proportionate deduction to be allowed to company while paying DDT under Section 115-O, if shareholder receiving dividend is exempt under a law that overrides Income Tax Act

The assessee in the present case declared a dividend of INR 1 per equity share during AY 2018-19, 2019-20 and 2020-21 and deposited dividend distribution tax ('**DDT**') on such dividend as per the provisions of Section 115-O of the IT Act. One of the shareholders of the assessee company was International Finance Corporation ('**IFC**') which was immune from all applicable taxation on its assets, property, income, operations and transactions under the IFC Act, 1958, having an overriding effect over the IT Act.

In light of the same, the assessee filed an application under Section 237 for the refund of DDT paid on the dividend paid to IFC. However, the Assessing Officer ('**AO**') rejected said claim stating that the chargeability of tax under Section 115-O in the hands of the assessee is exclusive of the taxability of such income in the hands of recipient. This decision was also upheld by the CIT(A) by placing reliance on the case of *Total Oil India Pvt. Ltd.* [(2023) 149 taxmann.com 332].

Before the ITAT, the assessee relied on the overriding effect of the IFC Act over the IT Act and argued that by making an investment in the assessee company, IFC had entered into a transaction within the scope of the IFC Act, 1958 and the dividend distributed in pursuance of this investment would fall within the ambit of the immunity provided under the IFC Act. It was the contention of the assessee that once an overriding effect exists, it is not necessary for the assessee to specifically establish an exemption under Section 115-O of the IT Act. Further, the assessee also relied on sub-section (1A) of Section 115-O of the IT Act and contended that if the statute has stipulated that amount of dividend paid to any person for or on behalf of the new

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pension system trust referred to any Section 10(44) is to be reduced, then similar exemption of income which is also enjoyed by IFC by virtue of a separate statute should also be reduced.

On the contrary, the Revenue argued that the intention of Section 115-O is to tax the additional profit of the company while distributing dividends and not the income of the shareholders of such company.

The Hon'ble ITAT upheld the reasoning of the CIT(A) to the extent that Section 115-O is charged on the company's profits. However, the ITAT agreed with the reliance placed by the assessee on sub-section (1A) of Section 115-O of the IT Act. The clause (ii) of the sub-section provides that any dividend paid to any person for or on behalf of the New Pension System Trust established under Section 10(44) shall be deducted while calculating the DDT liability of the company distributing such dividend. This clause was inserted based on the rationale that since the dividend distributed being a part of the income of NPS trust shall be exempted from tax under the IT Act, the company should also not be liable to pay DDT on such dividend.

Furthermore, the ITAT relied on the judgements of Karnataka High Court in case of *K. Ramaiah* (126 ITR 638) and Delhi High Court in *Dr. P. L. Narula* (17 Taxman 223) wherein the Courts have held that the immunity available for salaries of employees of certain foreign institutions like UN, World Bank, etc. is also available to pensions received by such employees even in the absence of specific provisions under the IT Act. Therefore, the ITAT concluded that the overall intent of providing a tax exemption to IFC under the IFC Act was to ensure that any transaction involving such entity shall be immune from income tax and accordingly, it was held that the assessee company shall be refunded the amount of paid DDT proportionate to the dividend distributed to IFC.

[*Polycab India Limited* v. *Assistant Commissioner of Income* Tax – Order dated 16 June 2025 in ITA No.4671/Mum/2023, ITAT Mumbai]

1) Set-off of business loss of PE allowed against interest income of foreign entity under India-UAE DTAA

2) India-UAE DTAA – 'Gross' in Article 11(2) – Loss cannot be equated with expenses

In this case, the assessee was a non-resident banking company having its head office in UAE and two branches that also qualified as a Permanent Establishment ('**PE**') in India. The assessee was a tax resident of UAE. During the course of its business, the assessee issued certain external commercial

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borrowings to Indian clients without the involvement of the Indian PEs. In the relevant assessment year, the assessee claimed the benefit of Article 11(2) of India-UAE treaty and accordingly its interest income was taxed as the concessional rate of 5% on a gross basis under the head 'Income from other sources'. During assessment proceedings, the AO rejected the position of the Assessee that the assessee had set of its interest income with the business losses of its PE in India and paid the tax at the rate of 5% on the remaining amount. The Assessee submitted that the term 'gross' for the purpose of Article 11(2) means 'the amount without allowing any deduction on account of expenses', and loss cannot be equated with expenses.

The AO was of the view that no set off of losses shall be allowed for taxation of gross interest. Further, once the assessee had claimed the benefit of the treaty, set off of income as per the Indian law shall not be allowed. This view was also confirmed by the DRP.

The ITAT examined the language of Article 11(2) of India-UAE tax DTAA and held that the first step is to determine the taxability of interest income in terms with the domestic law of the source country. Only after the income is computed in terms of the domestic law, then one has to again revert back to the treaty provisions for applicable tax rate on such income.

The ITAT observed that as per the provisions of the IT Act, the effect of Chapter VI which deals with aggregation of income and set-off and carry forward of losses and Chapter VIA which deals with deduction has to be given. Therefore, the ITAT upheld the hybrid approach of the assessee and allowed set off of losses.

As regards the meaning of 'gross' for the purpose of Article 11(2) of India-UAE DTAA, the ITAT upheld the position of the assessee that 'gross' means interest without claiming deduction of expenses but allows benefit of set off.

[*Abu Dhabi Commercial Bank PJSC Wework India Management Private Limited* v. *DCIT (International Taxation)* – TS 762 ITAT 2025 (Mum)]

Loan advanced by one entity to another shall be deemed dividend u/s 2(22)(e) if the assessee is a substantial shareholder in both the entities

In the present case, the assessee was a substantial shareholder in two companies named DIPL and KPPPL. During the relevant AY, DIPL advanced a loan of INR 16 lakhs to KPPPL. It was the contention of the AO that this amount should be treated as a deemed dividend under Section 2(22)(e) of the IT Act.

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However, the assessee contested this treatment on the grounds that the assessee only held 9% of shares in DIPL and that the said transaction was made in the ordinary course of business and was in the nature of an inter-corporate deposit.

In the appeal before the Hon'ble ITAT, it was observed that the documents which the assessee had submitted to prove that the shareholding of DIPL was only 9% were actually filed with the ROC after the issuance of show cause notice in the present case and were therefore, a conscious attempt to mislead the ITAT. The income tax return of DIPL clearly highlighted that the assessee held 50% shares in the company. Further, with respect to the alternative argument of the assessee, the ITAT relied on various judgements[5] and held that since the assessee was not involved in the business of lending money or advancing loans, it could not be argued that the loan was advanced in the ordinary course of assessee's business.

The ITAT also rejected the contention of the assessee that the amount in question was in the nature of 'deposit' and not 'loan' in the absence of any evidence to support the same. The ITAT referred to the judgement of *DCIT* v. *Dhariya Constructions P. Ltd.* [ITA No. 1440/Pune/2015] wherein the ITAT had distinguished between the meaning of an inter-corporate deposit and a loan.

Accordingly, it was held that all the pre-requisites of classifying as deemed dividend under Section 2(22)(e) were fulfilled by the said loan transaction.

[*Ajay S Dhumal* v. *ITO, Mumbai* – TS 745 ITAT 2025(Mum)]

[5] *Thomas Philip* v. *Interim Board of Settlement,* [2025] 174 taxmann.com 109 (Kerala); *Pr. CIT* v. *Dwarka Prasad Aggarwal,* [2022] 140 taxmann.com 32 (Delhi)

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