Direct Tax Vista

Your weekly Direct Tax recap

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1. TCS on foreign spends deferred and relaxed – understand how

Once it was known that TCS on foreign remittances u/s 206C(1G) of The Income Tax Act would be invoked from 1st July 2023, it was seen that advertisements for spending in foreign exchange were made by many tour operators and other such companies; This TCS is now deferred to 1st October 2023 and on a lighter vein it can be said that this deferment would give them some more time to such businesses to gain some more traction! Hence tax amendments can be a business opportunity too!

Going into the technicalities, in order to apply TCS on foreign remittances and foreign spends under LRS, an amendment was proposed to be invoked from 1st July 2023 in Section 206C(1G) of the Income Tax Act wherein TCS @20% was made leviable on remittances for foreign spends. The payment for these foreign spends could also be made vide international credit cards which was not under RBI scanner apropos Rule 7 of FEMA (Current Account Transaction) Rules 2000. Then in May 2023, The Finance Minister while replying to a debate in the Parliament requested the RBI to even bring international credit cards under the ambit of TCS which was done by deleting this Rule and hence all foreign spends even by international credit cards were also to be liable to TCS @20% or any other rate as per Section 206C(1G).

However important was that a robust process be laid for this wherein the holder of international credit card, before making any payment, would be asked by a pop-up message or similar mechanism on the nature of the transaction and when he does so, TCS would be automatically triggered and instead of say $10,000 and extra $2000 is collected. For seamless implementation it had to be an automated process just like an online payment made for say spending on hotels abroad wherein while your spend value is $10,000, but a final payment approval of an excess amount is

sought before payment is processed. However implementing this would require system changes by the Banks and Credit card companies which takes sometime. It is a trite that for a law to be implemented an efficient machinery should be available, otherwise the law becomes ineffective as is the case with more than 1000 Indian Laws. Hence, to implement this machinery the CBDT has allowed more time to banks and credit card companies by deferring this TCS by 3 months.

To top it up, it has now been decided as follows "**per individual per annum**" –

1. No TCS would apply upto a threshold of Rs.7 Lakhs spends on all categories (other than tour operators) as per section 206C(1G)(a), through all modes of payment, regardless of the purpose. Hence, post Rs.7 Lakhs, the following rates would apply-

   a) 0.5% (if remittance for education is financed by education loan);
   b) 5% (in case of remittance for education/medical treatment);
   c) 20% for others.

2. For spends on overseas tour program package u/s 206C(1G)(b), 5% TCS shall apply for the first Rs 7 lakhs; the 20% rate will only apply for expenditure above this limit.

Let's understand further by means of examples and clarifications as per Circular 10 of 2023 issued by CBDT on 30th June 2023 -

a. No TCS on foreign Credit Cards till 30th September 2023

b. If remittance of Rs 50 lakh under LRS is made in FY 23-24 by Mr A, the treatment would be as follows –

   A. Rs 10 lakh For overseas tour (from HDFC Bank) on 15th July 2023 – TCS @ 5% u/s 206C(1G)(b)
   B. Rs 10 lakh For education purpose (from HDFC Bank) on 15th Aug 2023 – TCS @ 5% u/s 206C(1G)(a)

C. Rs 10 lakh For medical treatment (from HDFC Bank) on 15th Oct 2023 – TCS @ 5% u/s 206C(1G)(a)

D. Rs 10 lakh for Purchase of goods (from International Credit Card) from overseas on 15th Dec 2023 - TCS @ 20% u/s 206C(1G)(a)

E. Rs 10 lakh For overseas tour (from Kotak Bank) on 15th Feb 2024 - TCS @ 20% u/s 206C(1G)(b)

F. Rs 10 lakh For Loan (from ICICI Bank) for educational purpose on 15th Mar 2024 - TCS @ 0.5% u/s 206C(1G)(a)

3. Important is that incase one books International travel separately and hotel separately and incurs other expenditure separately, then it will not come under "Overseas Tour" as per Sec 206C(1G)(b). To qualify as an overseas tour operator's services it should contain 2 out of the 3 expenditures i.e. International travel, hotel, other related expenditure.

2. No Change in Transfer Pricing Tolerance Limit

The CBDT vide Notification No. 46/2023 has confirmed that there are no changes to the tolerance limit for Transfer Pricing for the Assessment Year 2023-24. The notification provides for tolerance range of 1% for wholesale trading and 3% in all other cases for assessment year 2023-2024. It is certified that none will be adversely affected by the retrospective effect being given to the notification. Hence, if ALP varies up to 1% of the transaction price for wholesale traders and 3% for other taxpayers, the transaction price would be taken as ALP under the transfer pricing rules. Traders will be classified as "wholesale traders" incase Purchase Cost of Finished Goods is 80% or more of the total cost of trading and the Average Monthly Closing Inventory is 10% or less of the wholesale sales.

The Transfer Pricing Audits may thus be conducted just like last year.

3. Relief from penalty is not a right - To avoid penalty by invoking Sec 273B, 'reasonable cause' for failure must be shown

Most penalty cases are argued by taking Shelter u/s Section 273B which provides that no penalty shall be imposable on a person or the assessee for certain violations,

for any failure referred to in the said provisions, if he proves that there was "reasonable cause" for the said failure. The Hon'ble Supreme Court in the case of Hindustan Steel Ltd. vs. State of Orissa, held that where the offence is merely technical, even if the minimum penalty is prescribed, the authority should not impose penalty. However, where offences are continuous, the decision can be distinguished. Where a no:of times in the year, a Company received cash loan and paid back, then it can be said that the violation of Section 269SS is habitual. Further, penalty u/s Section 271D may still not be levied incase the offender proves that there was "reasonable cause" for the said violation. However, even if the payments are proved to be genuine but "reasonable cause" for violation of Sec 269SS is not shown, then penalty u/s 271D cannot be avoided as was held in the case of M/s LOVE SHOPPERS LTD Vs THE DCIT [2023-VIL-841-ITAT-RKT].

Relief from penalty is thus not a right but depends upon the facts of the case.

4. Deduction of ESOP expenditure on 'layout' basis and not 'payout' basis

Section 37. (1) of The Income Tax Act provides that *any expenditure …laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession.* Hence for claiming the deduction u/s 37(1), the expenditure must be "laid out or expended" and it is not necessary that it must be "paid out".

In an ESOP, a company undertakes to issue shares to its employees at a future date at a price lower than the current market price. The employees are given stock options at discount and the same amount of discount represents the difference between market price of shares at the time of grant of option and the offer price. The Supreme Court, thus in the cases of Bharat Movers and Rotork Controls India P. Ltd., has held that discount on issue of ESOPs is not a contingent liability but is an ascertained liability. Further, the primary object of ESOPs is not to waste capital but to earn profits by securing consistent services of the employees and therefore, the same cannot be construed as a capital expenditure. Hence ESOP expenditure

was allowed by The ITAT Mumbai on accrual basis in the case of GODREJ CONSUMER PRODUCTS LTD Vs DCIT, CIRCLE-14(1), MUMBAI [2023-VIL-839-ITAT-MUM].

5. No TDS u/s 195 on purchase of the copyrighted software itself

Generally, Licenses like SAP, etc are purchased to use the software of foreign vendors which are subject to TDS u/s 195 considering it as royalty. However, incase the copyrighted software itself is purchase then it does not remain a royalty or even Fees for Technical Service and the payment wouldn't be liable to TDS u/s 195. The issue is not settled in favour of the assessees by the decision of the Hon'ble Supreme Court in case of Engineering Analysis Centre of Excellence Pvt. Ltd. Vs. CIT (432 ITR 471) and was followed in the case of ADDL. CIT, SPECIAL RANGE-4, NEW DELHI Vs HINDUSTAN COCA COLA BEVERAGES PVT LTD [2023-VIL-845-ITAT-DEL]

6. Date of transfer of capital asset is the date of transfer of Possession and not the date of the development agreement or advance

Section 2 (47) (v) of Income Tax Act provides that "transfer", in relation to a capital asset, includes any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882);

Now, say a Development Agreement is signed in Year 1 in respect of lands which are agricultural, for formation of sites for which the conversion of land into non-agricultural land is necessary, a part advance is also received on the date of signing of this agreement. However, possession of lands for commencement of any work is provided only after the orders for conversion are issued in Year 3.

The question is whether the date of transfer shall be construed as Year 1 or Year 3 - whether the possession of land would construed to be handed over to the developer on execution of the agreement dated in Year 1 and the transfer of property have taken place in view of the section 2(47)(v) of the Act r.w. section 53A of the Transfer of Property Act, 1882 in Year 1.

The decision of Hon'ble Supreme Court in case of Seshasayee Steels (P.) Ltd. v. AIT reported in (2020) 115 taxmann.com 5 in this respect lays down that in order to attract provisions of section 53A of the Transfer Of Property Act The transferee must, in part performance of the contract, have taken possession of the property or any part thereof. The transferee (developer) must have performed or be willing to perform his part of the agreement. Further, a registered deed must be executed. It should not be a mere a license to enter the property for the purpose of carrying out development. As per the decision of The Hon'ble Karnataka High Court in case of CIT vs. Dr. T.K. Dayalu reported in (2011) 14 taxmann.com 120, capital gains will arise in the year in which full control and possession of land in question is given.

Another issue raised many a times is that say in the above example, the entire consideration was paid by the buyer in Year 1 after deduction of TDS u/s 194IA, then would the proposition change and the Capital Gain or Capital Loss be assessed in Year 1 as it would be deemed that the transfer took place in year 1 itself. The answer still will not change as transaction shall be treated as transfer only when possession has been taken or retained by buyer. Since possession of property has been handed over to buyer in Year 3, transfer would be considered to have taken place in Year 3 only.

To sum up, the capital gains are offered to tax in the year in which the following conditions are satisfied -

1. The year in which the transferee has taken physical possession of the property or any part thereof.
2. The year in which transferee has performed or is willing to perform his part of the agreement.
3. The year in which a registered deed is executed. An agreement for sale is not a registered deed.
4. A mere a license to enter the property for the purpose of carrying out development work would not be sufficient. But, as per the decision of The Hon'ble Karnataka High Court in case of CIT vs. Dr. T.K. Dayalu reported in (2011) 14

taxmann.com 120, capital gains will arise in the year in which full control and possession of property in question is given.

7. "Purpose Test" for determining whether a subsidy is capital/revenue receipt

To determine whether a subsidy receipt is to be treated as capital or revenue receipt, the 'purpose test' laid down by the Supreme Court in Commissioner of Income-tax v. Ponni Sugan and Chemicals Ltd. (2008) 306 ITR (SC) and in the case of CIT v. Chaphalkar Brothers Pune 88 taxmann.com 178 (SC), will have to be considered. The "purpose" for which the subsidy is material (capital expenditure or revenue expenditure). The point of time at which the subsidy is paid is not relevant. The source is immaterial.

Incase the subsidy is to run day to day operations, then it is a 'revenue receipt' and incase it is for expansion of an undertaking then it is 'capital receipt'. Hence VAT incentive on sales/purchases given to assessee for promoting investment of capital for industrial development and to generate employment in Kutch district, was held to be as 'capital receipt' in the case of DCIT, CIRCLE-1(1), RAJKOT Vs M/s AJANTA MANUFACTURING LTD [2023-VIL-851-ITAT-RKT]. Similarly, interest subsidy from Technology Upgradation Fund (TUF) was considered capital in nature, even though credit is netted off against interest expenditure in the case of DY. COMMISSIONER OF INCOME-TAX CENTRAL Vs M/s GRASIM INDUSTRIES LTD. [2023-VIL-856-ITAT-MUM].

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