Direct Tax Vista

Your weekly Direct Tax recap

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Friends

We are pleased to put forth this issue of DTV in Three Sections as under -

Section I - Coverage and Updates on Income Tax Act Revamp (Comprehensive Review) from 1st February 2025 as announced by the Union Finance Minister in The Budget (No.2) in 2024.

Section II - Video on Weekly Developments under Income Tax, International Taxation & International Trade

Section III - Coverage of most critical issues in Income Tax, International Taxation & International Trade in the bygone week.

We hope that this revamped DTV would assist you in your professional spheres.

Section I - Coverage and Updates on Income Tax Act Revamp (Comprehensive Review) from 1st February 2025 as announced by the Union Finance Minister in The Budget (No.2) in 2024

The suggestions for Income Tax Act Revamp should not include –

1. Any suggestion for exemption, it should be a part of the pre-budget suggestion
2. Suggestions on mere procedure change
3. On the Rules front too much, but more on the Income Tax Act front.

In this backdrop, we put forth our following suggestions this week for the Income Tax Revamp. You may also put forth your suggestions on https://eportal.incometax.gov.in/iec/foservices/#/pre-login/ita-comprehensive-review -

1. Scrapping of the Old Regime totally and rationalising the Income Tax slabs under the new regime -

The Govt. has come out with an analysis that on an income of Rs.7Lakhs, an individual had to pay Income Tax of Rs.29,000 approx in FY14-15 after a deduction towards investment and Mediclaim and under the new tax regime, they have to pay NIL on the same level of Income today.

It is a fact that today under the new tax regime, they have to pay NIL on the same level of Income. However, considering the Cost of Inflation of approx. 6% pa, the present value of Rs.7 Lakhs income of FY 14-15 is Rs.12.50 Lakhs today and on which the tax is Rs.90,000 in the new regime in FY24-25.

Hence, the Government should consider and make the new regime as the only regime as the Income Tax Act goes for a comprehensive review on 1st Feb 2025. However, they must also consider easing out the tasx rate in the new regime.

2. Ease of Compliance

The revamping should be designed in a way that makes compliance way more simpler for both individuals and businesses operating in India. With different deadlines for filing income tax returns, TDS return, tax audit, transfer pricing etc, there are chances of missing the dates, leading to penalties.

Unification of dates should be done to the best extent possible for all assesses.

Section II - Video on Weekly Developments under Income Tax, International Taxation & International Trade

The URL for this week's video is hereinunder-

https://youtu.be/cEwB0GDooe8

Section III - Coverage of most critical issues in Income Tax, International Taxation & International Trade in the bygone week

1. "Date of initiation" for calculating time barring period of Issuing Order for penalty u/s 275

In terms of Section 275(1)(c) of the Income Tax Act, no order imposing penalty could be passed after expiry of six months from the end of the month in which the action for imposition of penalties was initiated. The relevant provision is as under -

> ***275.*** *Bar of limitation for imposing penalties*
> *(1) No order imposing a penalty under this Chapter shall be passed-*
> *(c) in any other case, after the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed, or six months from the end of the month in which action for imposition of penalty is initiated, whichever period expires later."*

Now the question is what is the "date of initiation of penalty proceedings".

Consider that the Assessing Officer made reference for penalty proceedings on 25.09.2023 to the JCIT range, but the JCIT issuing the show cause notice on 04.08.2024 and the Order on 15.11.2024. Whether the "date of initiation of penalty proceedings" is 25.09.2023 when the Assessing Officer's made reference for penalty proceedings to JCIT or 04.08.2024 when the JCIT issued the show cause notice.

Incase, "date of initiation of penalty proceedings" is 25.09.2023 then the time barring period for issuance of Order is 31.2.2024.

Incase "date of initiation of penalty proceedings" is 04.08.2024 then the time barring period for issuance of Order is 31.2.2025.

Hence, we go into analysis of the meaning of the word ‘initiate’

- The expression initiate is not defined under the Act and must be construed in its normal sense.

- The Shorter Oxford English Dictionary defines the word ‘initiate’ as “to begin, commence, enter upon, to introduce, set going, originate.”

- In Webster’s Third New International Dictionary, the word ‘initiate’ has, inter alia, been defined thus: “to begin or set going: make a beginning of: perform or facilitate the first actions, steps, or stages of:”

- The Words and Phrases (Permanent Edition) defines ‘initiate’ to mean: “an introductory step or action, a first move; beginning; start, and to initiate as meaning – to commence.”

- In Om Prakash Jaiswal v. D.K. Mittal & Anr.: (2000) 3 SCC 171, the Supreme Court had considered the meaning of the expression ‘initiate any proceedings for contempt’ by referring to the dictionary meaning of the said word. It is relevant to refer to paragraph 10 of the said decision, which is set out below:

> *“10. The expression—"initiate any proceedings for contempt” is not defined in the Act. Words and Phrases (Permanent Edition) defines “initiate” to mean – an introductory step or action, a first move; beginning; start, and “to initiate” as meaning to commence. Black’s Law Dictionary (6 th Edn.) defines “initiate” to mean commence; start; originate; introduce; inchoate. In section 20, the word “initiate” qualifies “any proceedings for contempt”. It is not the initiation of just any proceedings; the proceedings initiated have to be proceedings for contempt.”*

The expression ‘action for imposition of penalty is initiated’ must, thus, clearly refers to the date on which the first introductory step for such action is taken, it must

necessarily mean the start of such action. It must mean the commencement of action for imposition of penalty. As noted above, the AO had found that it was the admitted case that the assessee had defaulted and accordingly, made a reference to the learned JCIT on 25.09.2023. This was obviously for the purposes of imposition of penalty. The reference, thus, clearly marked the first step for initiation of action for imposition of penalty. The Show Cause Notice issued subsequently was to provide the assessee an opportunity to show cause why penalty not be imposed.

Hence, the beginning of the action for imposition of penalty had initiated with the AO determining that there was a cause for such imposition on 25.09.2023 as was held in **COMMISSIONER OF INCOME TAX (TDS)-2 DELHI Vs TURNER GENERAL ENTERTAINMENT NETWORKS INDIA PVT LTD [2024-VIL-209-DEL-DT].**

2. Unexplained money cannot be declared as "income from other sources" until the source is clear

Incase during a search/ survey, cash is seized and assessee has no answer, a way thought out can be is to disclose under the head 'income from other sources' to protect oneself from the rigours of Sec 69A r.w.s. 115BBE of The Income Tax Act, and a tax rate of 60%. To escape the rigours of Sec 69A and 115BBE, the assessee should

A. Have contemporaneous demonstrable evidences for the source
B. Identify genuine payers of such moneys

If the AO does not verify such contemporaneous demonstrable evidences for the source and Identify genuine payers of such moneys, then even after the assessment, the PCIT can invoke Sec 263 as was held for revision of the order being erroneous and pre-judicial to interest of revenue as was held in the case of **SHRI VENKATA KRISHNA TATINENI Vs ASST. COMMISSIONER OF INCOME TAX [2024-VIL-1588-ITAT-HYD].**

3. Bank Fore-closure charges are deductible expenses u/s 37 of Income Tax

It is a norm to shift loans from one bank to other due to lower interest rates. However certain pre-closure charges/ premiums need to be paid in the process. The question before the Hon'ble Madras High Court in the case of **M/s EIH ASSOCIATED HOTELS LIMITED Vs COMMISSIONER OF INCOME TAX – I [2024-VIL-206-MAD-DT]**, was whether pre-closure premium can be claimed as revenue expenditure under Section 37.

The Delhi High Court in '**Gujarat Guardian**' held that the prepayment premium of Rs.8 crores represents present value of the differential rate of interest that would be payable by the assessee if the loan had not been restructured. Hence, applying Section 36 (1)(ii) read with Section 2(28A) of the Act, the claim for deduction was allowed as revenue expenditure. The Revenue would distinguish that decision pointing out that neither the Supreme Court in the case of *Madras Industrial Investment Corporation Limited* nor the Delhi High Court in the case of *Gujarat Guardian* had dealt with pre-closure premium. However it was held that -

1. Prepayment premium paid for restructuring loans was a commercially expedient business decision aimed at reducing interest costs and ensuring financial benefit.

2. It constitutes an allowable revenue expenditure under Section 37(1), aligning with established jurisprudence, such as the Delhi High Court decision in Gujarat Guadian Ltd.

3. The foreclosure charges represented additional interest and not a capital expense, as argued by the revenue

4. TRCs cannot be questioned until the Department has strong corroborative evidence

The question in the case of **TRICENTIS GMBH Vs THE DCIT [2024-VIL-1558-ITAT-DEL]** was whether the receipts from sale of software licenses to Indian

customers is taxable in India as business income. In light of the decision by The Hon'ble Supreme Court in case of Engineering Analysis Centre of Excellence Pvt. Ltd. it was held that it was not taxable in India. Once this was established, it was questioned whether the assessee has set us business in a low tax Country only for treaty shopping.

Here it was held that where an assessee's status as a tax resident of a Country has been duly recognized by the Revenue Department of that Country and authorities while issuing Tax Residency Certificates (TRC) on year-on-year basis, they cannot be denied treaty benefits. Unless the department brings on record strong corroborative evidence to establish that the assessee is a sham/shell company having no legal or commercial substance, the sanctity of the TRC cannot be doubted.

5. Where interpretation of country of residence about applicability of a treaty provision is not the same as that of source jurisdiction, credit of taxes cannot be declined

Incase of professionals rendering services outside India, Article 12 of the DTAA provides that income from professional services or other activities of independent characters would be taxable in the resident country. However, clause 4 of the Article 12 provides that such payments would not constitute 'fee for technical services' only if such payment is made to **an individual** for carrying out independent professional services referred to in Article 14. Hence Japan Authorities consider that income earned by a 'firm' of lawyers in source Country would be taxable in that Country and have withheld tax.

DTAA provisions don't require that state of residence eliminate the double taxation in all cases where state of source has imposed its tax by applying to an item of income, a provision of convention that is different from what the state of residence considers to be applicable. Therefore, in all cases in which interpretation of residence country about applicability of a treaty provision is not the same as that of source jurisdiction about the provision and yet the source country levied taxes whether directly or by way of tax withholding, tax credit cannot be declined in the country of

residence as was held in the case of **ACIT Vs AZB AND PARTNERS [2024-VIL-1553-ITAT-MUM]**

6. FPI to FDI reclassification: New RBI framework

The Reserve Bank of India Vide its circular dated 11 November 2024, has finalised an operational framework for reclassification of Foreign Portfolio Investment made by Foreign Portfolio Investors (FPI) to Foreign Direct Investment (FDI) under Foreign Exchange Management (Non-debt Instruments) Rules, 2019 in case of any breach of the investment limit by the FPIs concerned. As per the RBI framework, the foreign portfolio investors have the option of divesting their holdings or reclassifying such holdings as FDI if the 10 per cent cap is breached. This reclassification has to be completed "within five trading days from the date of settlement of the trades causing the breach.

This would give more elbow room to those FPIs who wish to raise their stakes in Indian Equities. It is understood that there are around 17 companies listed on the National Stock Exchange (NSE) where a single FPI has holdings of up to 9 per cent. Key Highlights of the Operational Framework for Reclassification of FPI to FDI

1. Reclassification is not permitted in sectors where FDI is prohibited under the Rules.

2. Mandatory Approvals
   - FPIs are required to obtain the concurrence of the Indian investee company.
   - Obtain requisite approvals from the Government of India, where applicable, including approvals for investments originating from countries sharing land borders with India.
   - Investments exceeding prescribed limits must comply with FDI regulations.

3. Role of Custodian
   - The FPI must notify its intent to reclassify to its custodian.

- Upon notification, the custodian shall freeze purchase transactions in the equity instruments of the Indian company until the reclassification process is concluded.
- Failure to secure necessary approvals or concurrence within prescribed timelines shall result in compulsory divestment of the excess investment.

4. Reporting Obligations

Sr. No.	Event triggering excess investments	RBI reporting	Entity responsible
1	Fresh issuance of equity instruments	Form FC-GPR within 30 days	Indian company
2	Acquisition of equity instruments from the secondary market	Form FC-TRS within 60 days	FPI

5. Completion of Reclassification

- Upon verification of compliance with reporting requirements, the custodian will lift the freeze on the equity instruments.
- The date of the investment breach shall be treated as the effective date of reclassification.

6. FDI Treatment Post-Reclassification

- Once reclassified, the entire investment by the FPI in the Indian company will be treated as FDI, regardless of whether the holding subsequently falls below the 10% threshold.

7. Investor Group Consideration

- The FPI, along with its investor group, shall be treated as a single entity for reclassification purposes.
- Such investments will be governed under Schedule I of the Rules, which deals with FDI.

7. RBI includes spot deals to expand forex transactions reporting requirements

The RBI vide Notification No RBI/2024-25/89 FMRD.MIOD.07/02.05.002/2024-25 dated 8th Nov 2024, issued clarification regarding Reporting of Foreign Exchange Transactions to Trade Repository. Authorised Dealers shall report all inter-bank FX contracts undertaken by them to the TR of CCIL with effect from February 10, 2025 as per the timelines mentioned. The reporting requirement of forex transactions has been expanded to include foreign exchange spot deals to ensure completeness of transaction data in the trade repository (TR) of the Clearing Corporation of India.

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