Annexures

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4. Annexure 4 - Improve interface with Central Processing Centre (CPC)

4.1. Background:

- Currently, income tax returns e-filed by taxpayers are centrally processed at CPC, Bangalore u/s 143(1) of the Income Tax Act (Act). The objective for establishing CPC was to expeditiously determine the tax payable or any refund due to the taxpayers or check for any mistakes apparent in the income tax return.

- Statutorily, the return processing framework is governed by s.143(1) to s.143(1D) of the Act and Centralized Processing of Returns Scheme. S.143(1)(a) permits CPC to make following adjustments while processing the ITRs:-

    - any arithmetical error in the return

    - an incorrect claim apparent from any information in the return. This is defined to mean a claim, on the basis of an entry, in the return,-

        - of an item, which is inconsistent with another entry of the same or some other item in such return;

        - in respect of which the information required to be furnished under the Act to substantiate such entry has not been so furnished; or

        - in respect of a deduction, where such deduction exceeds specified statutory limit which may have been expressed as monetary amount or percentage or ratio or fraction

    - disallowance of loss claimed, if return of the tax year for which set off of loss is claimed was furnished beyond the due date specified u/s. 139(1)

    - disallowance of expenditure or increase in income indicated in the audit report but not taken into account in computing the total income in the return

    - disallowance of deduction claimed u/s. 10AA or Chapter VIA-C if the return is furnished beyond due u/s. 139(1)

- The first proviso to s.143(1) casts statutory obligation on CPC to give prior intimation of proposed adjustment to taxpayer and consider taxpayer's response before making such adjustment. It further provides for minimum thirty days time for taxpayer to provide response to the proposed adjustment.

- However, there are various hardships being faced currently by taxpayers in such processing which are summarized below:-

    - Anomalies in ITR utility

- Anomalies in CPC return processing software

- Non-provision of statutory opportunity of prior intimation before making adjustment

- Non-consideration of taxpayer's response to prior intimation – adjustments are mechanically made

- Delays or refusal in carrying out rectifications

- Non-redressal of adjustments made u/s. 143(1) in scrutiny assessment

- Each of them are explained and illustrated in following paras.

4.2. Rationale:

➢ **<u>Anomalies in ITR utility</u>**

- It is often seen that ITR utility contains anomalies which lead to adjustments u/s. 143(1). For instance, if there is no change in method of valuation of closing stock, the ITR utility does not permit reporting of figures of increase or decrease in profit due to s.145A adjustments for adding the amounts of taxes, duties, etc. This leads to s.143(1) adjustment based on number reported in tax audit report (TAR) towards increase in profit as part of s.145A adjustment by ignoring the numbers reported towards decrease in profit. The ITR form do not contemplate deemed LTCG u/s. 54F(3) on transfer of residential house within a period of 3 years which is taxable at 10%/12.5% u/s. 112A since the original capital gains from which s.54F exemption was claimed were in respect of listed shares u/s. 112A. The ITR utility provides for taxation of deemed LTCG at 20% rate alone which is incorrect.

➢ **<u>Anomalies in CPC return processing software</u>**

- The CPC return processing software merely picks up adjustments leading to increase in total income by ignoring the adjustments reported in audit report leading to decrease in total income on the same issue. It is true that s.143(1)(a)(iv) permits CPC to make adjustment in respect of disallowance of expenditure or increase in income indicated in the audit report but not taken into account in computing the total income in the return. But it is submitted that such adjustments should be with respect to net figure of disallowance of expenditure or increase in income as reported in audit report and not the gross figure

- As another illustration, Clause 25 of tax audit report requires reporting of amount of profit chargeable to tax u/s. 41 even if it is already credited to P&L. But it is again added by CPC ignoring that the said amount is already credited in books of accounts under "Other Income" and is offered to tax in the return form.

- In Schedule MAT, the amount of tax (net-off of deferred tax) is required to be added back to compute the book profit. However, in Schedule Part A – P&L, the amount of current tax and deferred tax are to be reported separately. Ideally, the addition made in Schedule MAT should be compared with total amount of current tax + deferred tax reported in Schedule Part A – P&L. However, in cases where the deferred tax amount is negative, the addition made in Schedule MAT is compared with current tax only, and an addition is being made to book profit computed as per section 115JB. Such adjustment ought not to be made, and suitable changes be made to the CPC return processing software.

- It may be noted that role of tax auditor as explained by ICAI in its Guidance Note on Tax Audit u/s. 44AB is to furnish the facts required by the Assessing Officer to determine whether or not disallowance is required. The tax auditor's opinion about disallowance of expenditure or taxability of receipt is not binding either on taxpayer or Assessing Officer. Hence, it is submitted that the power to make adjustment u/s. 143(1)(a)(iv) with respect to disallowance of expenditure or increase in income indicated in audit report must not be used indiscriminately to make adjustments merely because it is indicated so in the tax audit report. The power must be used with appropriate care and caution to make adjustments only in respect of patently is allowable items or inadvertently missed incomes after affording proper opportunity of hearing to taxpayer.

➢ **Non-provision of statutory opportunity of prior intimation before making adjustment**

- It has been experienced that various unilateral adjustments as illustrated above are being made by CPC without even affording an opportunity to the taxpayer for some of the adjustments thereby even violating the principles of natural justice. It is also contrary to express statutory requirement of first proviso to s.143(1) to give prior intimation to taxpayer and consider his response before making any adjustment.

- There have been instances where details of the proposed adjustments are not shared with the taxpayer apart from the mention of the schedule of the return of income where unexplained adjustment has been carried out.

➢ **Non-consideration of taxpayer's response to prior intimation – adjustments are mechanically made**

- Even where prior intimation is given for response of the taxpayer, it is noticed that simple and straight forward response of the taxpayers are not considered at all while issuing final intimation under section 143(1). There is no express mention why taxpayer's response is not considered/rejected by CPC. It is not clear whether taxpayer's response is considered by a competent officer who can easily identify the erroneous nature of adjustment proposed or by software algorithm or by a person not equipped to deal with such issues. There is no opportunity of personal hearing to taxpayer to explain the issue. In fact, Rule 12 of Centralised Processing of Returns Scheme specifically prohibits any personal appearance before CPC. This makes it difficult for the taxpayer to explain why a particular proposed adjustment is not warranted.

- Also, it is observed that, in certain cases, sufficient time is not provided to the taxpayer to furnish its response to the adjustments proposed to be carried out which is against the statutory requirement of granting 30 days from issue of intimation of proposed adjustments as provided under second proviso to section 143(1) (a) of the Act.

➢ **Rectification of mistakes**

- It is noticed that rectification application filed by taxpayers against the erroneous adjustments made under section 143(1) of the Act are not considered and as a result the rectification applications are kept pending constraining the taxpayer to approach the appellate authorities for seeking appropriate relief. The taxpayer continues to receive reminders and notices for coercive actions for outstanding demands despite pendency of disposal of rectification petitions.

- Where erroneous adjustments are proposed by the CPC in 143(1) order, during the 143(3) proceedings, the AO has, in some cases, not been able to rectify such errors resulting into undue hardship to the Assessee. In certain cases, the rectification rights are transferred to Jurisdictional AO whereas the assessment is done by Faceless AO. Accordingly, such errors do not get rectified by the Faceless AO and separate channel gets opened with the Jurisdictional AO. In few other cases, rectification rights are not transferred to the Jurisdictional AO and stay with the CPC and the income tax portal also does not reflect the actual status of the same.

- It may also be mentioned that the CPC does not respond to taxpayer's communication despite sending several reminders.

➢ **Non-redressal of adjustments made u/s. 143(1) in scrutiny assessment**

- Where adjustments are made on processing returns u/s. 143(1) and the case is subsequently picked up for regular scrutiny or reassessment, it is noticed that the Faceless Unit/AO starts with total income after s.143(1) adjustments and not total income as per return. The Faceless unit/AO does not give opportunity to taxpayer to explain why adjustments made u/s. 143(1) against which rectification petitions or appeals are pending should not be perpetuated in the regular assessment/reassessment order. In fact, the Faceless Unit/AO who are statutorily required to give personal hearing to the taxpayer are best placed to understand and rectify the erroneous adjustments whether arising out of anomalies in ITR utility or CPC return processing software or due to inadvertent mistakes by taxpayer while filing ITR.

- The adjustments being made under section 143(1) of the Act are leading to unnecessary harassment to the taxpayer forcing the taxpayer to approach appellate authorities over trivial matters and resulting in waste of time and resources over such matters for both taxpayers and Government, thereby increasing tax litigation.

4.3. Recommendations:

➢ In order to achieve desired objectives of section 143(1) of the Act and CPC Scheme 2011, following measures are recommended for kind consideration of CBDT:-

- The anomalies in ITR utility and CPC return processing software as pointed out in foregoing part of these representations may be addressed at the earliest. There may be many such anomalies experienced by large number of taxpayers across the country. While there exists helpline and email support on ITR filing portal, in many cases, taxpayers face difficulty in explaining the issues over a call or on email. It would be good if DGIT (Systems) or relevant offices in CPC hold regional camps to interact with taxpayers and professional/industry chambers to understand such anomalies and appropriate way to address them.

- Scope of processing of income tax returns by CPC should strictly be limited to determination of any tax payable or refund due to the taxpayer or determination of any mistake apparent from the record and not beyond the same. It must be clarified that the scope of jurisdiction of CPC u/s. 143(1) is the same as jurisdiction u/s. 154 to rectify errors apparent from record and not delve into debatable issues.

- Instructions may be given to CPC to clarify that adjustments in respect of disallowance of expenditure or increase in income indicated in audit report can be made only in respect of patently disallowable items or inadvertently missed incomes after affording proper opportunity of hearing to taxpayer. In particular, no such disallowance or addition can be made where the issue is covered in taxpayer's favour by any judicial precedent.

- There should be proper service level escalation framework of CPC communicated to taxpayers to ensure transparency and accountability in functioning of CPC. The CPC (included outsourced agency) staff should be adequately trained to identify debatable issues for which adjustments cannot be made and there should oversight of experienced senior officials to keep a check on unwarranted adjustments.

- Any adjustment proposed to be made by the CPC should only be made after providing complete details of the adjustment as well as sufficient time as per law for the taxpayer to furnish a response. The response must be considered by competent officer who can understand the technical and legal nuances of issues involved.

- Rule 12(i) which prohibits personal appearance before CPC may be amended to permit personal appearance through video conferencing for the limited purposes of explaining why proposed adjustment or rectification prejudicial to the taxpayer should not be made. This is very critical since one cannot expect algorithms and data processors to appreciate the nuances of income tax law. A personal interaction with taxpayer to understand the issue enables faster resolution of the issue and avoids repetitive reminders and rectification applications.

- Rectified applications or rectified return of income filed electronically should be disposed off within reasonable time which will surely eliminate the need to unnecessarily approach the appellate authorities seeking redressal of the unwarranted adjustments. There should be clarity on who can make the rectification and the taxpayer should not be made to shuttle between CPC/Faceless Unit and Jurisdictional AO.

- Before adopting the total income as per s.143(1) intimation as start-point for regular assessment, the AO must follow the same process as adopted for making additions in regular assessment i.e. after giving proper opportunity of hearing to the taxpayer including personal hearing where so desired by the taxpayer.

- CPC should commission a process review or an audit to identify process gaps and faulty logic and unwarranted manual overrides which result in denial of TDS credits appearing in Form 26AS of taxpayer and claimed by taxpayer in return of income.

5. Annexure 5 - Representation on Notification in Official Gazette under section 90 in view of judgement of Hon'ble Supreme Court on Most Favoured Nation (MFN) clause

5.1. Background

Meaning of MFN Clause and litigation issues before the Hon'ble Supreme Court ('Hon'ble SC') in case of Nestle SA[1]

- Double Taxation Avoidance Agreements ('DTAAs') are generally supplemented with 'Protocols' which operate as an addendum to DTAA. The Protocols to India's DTAA with certain countries, which are members[2] of Organisation of Economic Cooperation and Development (OECD), have a Most Favoured Nation (MFN) clause which provides that if after the signature/entry into force of the tax treaty with the first State (original treaty), India enters into a DTAA on a later date with the third State, which is an OECD member, providing a beneficial rate of tax or restrictive scope for taxation of dividend, interest, royalty, Fees for Technical Services etc. the same benefit should be accorded to first State.

- This issue has been a matter of litigation in India. Hon'ble Delhi High Court (HC) in case of Concentrix Services and Optum Global's case (W.P.(C) 9051/2020 and W.P.(C) 882/2021, CM Appl. 2302/2021 respectively) extended the benefit of lower withholding tax rate of 5 percent on dividend provided in the India-Slovenia DTAA by invoking the MFN clause under India-Netherlands DTAA.

- This decision was subsequently followed by various courts in cases like

  a) *M/S Nestle SA versus Assessing Officer Circle (International Taxation)-2(2)(2), New Delhi (W.P.(C) 3243/2021),*

  b) *Deccan Holdings BV vs Income Tax Officer &ANR (W.P.(C) 14602/2021)*

  c) *Cotecna Inspection SA Vs Income Tax Officer Ward International Tax (W.P.(C) 14602/2021)*

  where courts allowed the benefit of lower withholding rate pursuant to MFN clause to taxpayers. Further, countries like Netherlands, France, Switzerland have issued clarifications suggesting that in their understanding MFN clause has automatically resulted in benefit basis operative favourable treaties including with members which attained OECD membership later to their signing of treaties with India.

- Further, Hon'ble Delhi HC ruling in *Steria (India) Ltd. Vs Commissioner of Income Tax (W.P.(C) 4793/2014 & CM APPL. 9551/2014)* invoked the MFN Clause in the

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[1] Assessing Officer Circle (International Taxation) vs. M/s Nestle SA, 2023 INSC 928 [Civil Appeal No(s). 1420 of 2023]

[2] Illustratively, Netherlands, France, Switzerland, Sweden, Spain, Hungary

Protocol to India-France DTAA to grant the benefit of a restricted provision of Fee for Technical Services contained in India-UK DTAA by virtue of the 'make available clause'.

- Due to lack of guidance in Indian context, representations were made before Indian tax authorities seeking clarification on India's stand on application of MFN clause. Considering the same, the CBDT issued the Circular No. 3/2022, dated 3 February 2022 clarifying its position.

- Vide the aforesaid circular, it has been clarified that the third State must be a member of OECD both at time of conclusion of the DTAA with India as well as at the time of applicability of the MFN clause. Further, a notification under the provisions of Income Tax Act, 1961 ('the Act') was required to implement the provisions of DTAA as also any amendments to DTAA. However, it is a well settled principle that the any circular or instruction issued by CBDT is binding on the tax authorities but not on courts who are discharging judicial functions and therefore the provisions of MFN clause continued to be the subject matter of debate.

5.2. <u>Summary of the Judgement of SC in case of Nestle S.A.</u>

- The issue of availability of beneficial provision of MFN clause has been settled by the Hon'ble SC in a batch of appeals with the lead case being of Assessing Officer Circle (International Taxation) vs. M/s Nestle SA, 2023 INSC 928 [Civil Appeal No(s). 1420 of 2023] wherein the Hon'ble SC adjudicated on two issues: a) whether MFN clause is to be given effect to automatically upon occurrence of a "trigger event" (namely, the date when India enters into DTAA with a third state granting a beneficial treatment) or through a notification issued by the Government; and b) whether there is any right to invoke MFN clause with respect to provisions of the third country with which India has entered into DTAA, which was not a member of the OECD at the time of entering the DTAA.

- In this regard, the Hon'ble SC ruled that in order to give effect to a DTAA or any Protocol changing its terms or conditions, which has the effect of altering the existing provisions of the Act, notification under Section 90(1) of the Act is necessary and mandatory. Further, it has been held that the benefits arising from DTAA pursuant to the MFN clause contained therein are essentially inert and non-binding, unless officially notified by the government. Unlike other countries, mere signing or ratification of a treaty does not become enforceable in India, as exclusive power to legislate the treaties entered by India lies with the Parliament. Even with reference to MFN clause already agreed as part of existing treaty, the beneficial provisions entered into with third country cannot be made applicable unless a notification is issued.

- On the aspect of the time period when a third country should be an OECD member in order to apply the beneficial treatment accorded to such country by invoking the

MFN clause, the SC held that the expression 'is' in the sentence 'third state which is a member of OECD' of MFN clause, has a present significance and derives the meaning from the context. Therefore, if a party seeks to avail the beneficial treatment based on existence of DTAA between India and another third country which is an OECD member state, the relevant date for evaluating OECD membership is the initial date on which treaty containing MFN clause was signed, and not any subsequent date when that third country becomes an OECD member.

- This is a significant ruling in the context of interpreting Indian tax treaties. The decision is likely to affect claims that non-resident taxpayers have made regarding restrictive source taxation of interest, royalties, fees for technical services (FTS), dividends, etc. by relying on the MFN provisions and its scope as understood by lower courts. As a binding SC decision, the ruling may potentially impact all pending assessments and related proceedings irrespective of the stage of the dispute.

5.3. **Issues under consideration and our recommendations**

We have bifurcated issues and our recommendations into 2 categories viz.

- Category A: Application of automatic MFN clause in DTAA with first state and

- Category B: Taxation of dividends on account of subsequent accession of third state to OECD

5.4. Category A: Application of automatic MFN clause

Issue:

- As stated above, the first issue before SC was whether MFN clause in the treaty with the first state is to be given effect to automatically or through a notification issued by the Government even where the duly notified treaty with the first state contains MFN clause which is automatic i.e. which grants same benefits as third country treaty which is a OECD member on the date of signing third country treaty, without the need for any further intimations or negotiations by competent authorities. (E.g., Netherlands, Sweden, Hungary, France, Spain, Belgium). For instance, MFN clause in protocol to India-France treaty states as follows:-

> *"7. In respect of articles 11 (Dividends), 12 (Interest) and 13 (Royalties, fees for technical services and payments for the use of equipment), if under any Convention, Agreement or Protocol signed after 1-9-1989, between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate of scope provided for in this Convention on the said items of income,* ***the same rate or scope as provided for in that Convention, Agreement or Protocol on the said***

> ***items income shall also apply under this Convention, with effect from the date on which the present Convention or the relevant Indian Convention, Agreement or Protocol enters into force, whichever enters into force later**."*

- As per SC ruling, for MFN clause to come in effect, a separate notification for the same under Section 90(1) of the Act needs to be issued by the Government. The above ruling states that no automatic treaty benefit is available to NR's/foreign companies, unless a notification in this regard has been issued in India.. This is applicable even for a treaty which contains automatic MFN clause as above.

- This would have wide ranging ramifications on cases where MFN benefit under various tax treaties have been claimed in the past based on automatic MFN clause.

- It is relevant to note that the first ruling on this issue was rendered in by Kolkata Tribunal in the case of DCIT vs. ITC Ltd. (2002) 82 ITD 239 (Cal) which held that no fresh notification is required to apply automatic MFN clause in the India-France DTAA. This ruling appears to have been accepted by the Tax Department since it was not agitated further before the Kolkata High Court (even though the tax effect involved was well above the monetary limits for not filing appeals). There was solitary AAR ruling in the case of Steria (India) Ltd. (2014) 364 ITR 381 (AAR) which held that a fresh notification is required to apply automatic MFN clause but this was reversed by Delhi HC in (2016) 386 ITR 390 (Del) which held that it is not necessary to notify the protocol to India-France DTAA and it is also not necessary to notify the DTAA with the third state for MFN benefit to become effective. All other Tribunal and Delhi HC rulings favoured the taxpayer.

- The payers located in India, who have bona fide deducted and deposited withholding tax at lower rates by considering the MFN benefit supported by multiple favourable rulings, may face demands of tax and interest under Section 201 of the Act. Indian headquartered multinational corporations (as payers) are also adversely impacted by this ruling, specifically those that have international transactions with countries with whom India has DTAAs that contain the automatic MFN clause.

- Additionally, the possibility of past assessment proceedings being re-opened as a result of this ruling could generate further uncertainty and potential liabilities.

- This ruling, if applied in a retrospective manner by the tax administration, could negatively impact the investment environment in India. The additional burden on account of tax and interest could potentially discourage foreign companies from investing or continuing their operations in the country.

- As you may appreciate, the judgment highlights the crucial role that the Government plays in international tax matters by notifying beneficial provisions of DTAAs with third states, and by ensuring timely notifications, we can delay or resolve potential legal challenges concerning the enforcement of MFN clauses in DTAAs. At Appendix A is a list of illustrative treaties containing automatic MFN clause which are impacted because no notification has been issued till date.

- At the root of the controversy is absence of notification for clarifying the benefit of automatic MFN clause which was intended by the treaty negotiators to take effect from the date of “trigger event”. Therefore, all the adverse implications for past years can be avoided if the Central Government notifies the effect of automatic MFN clause from date of trigger event from which they were intended to be applied by treaty negotiators of both countries. It will put the entire controversy to rest and avoid any adverse actions for past years.

Recommendations:

- To address the situation, it is, therefore recommended, to collate the list of tax treaties contain automatic MFN clause (Refer illustrative list at Appendix A) and notify the same in Official Gazette from date of trigger event (from which they were intended to be applied by treaty negotiators of both countries).

- The Notifications may be on lines of those notified for, illustratively:

  - Canada (where treaty benefit was granted retrospectively for any contract signed after 12 December 1988, vide a notification issued on 24 June 1992) and

  - France (where treaty benefit was granted retrospectively from 1 April 1995 for interest, and from 1 April 1997 for dividends, vide a notification issued on 10 July 2000) and

  - Netherlands (where treaty benefit was granted retrospectively from 1 April 1997 for dividends and interest, vide a notification issued on 30 August 1999).

  More particularly, in context of France, the restrictive condition of “make available” for fees for technical services (FTS) may be notified on lines of India-US treaty signed on 12 September 1989 (when USA was a member of OECD) & entered into force on 18 December 1990 or India-UK treaty signed on 25 January 1993 (when UK was OECD member) & entered into force from 26 October 1993. Such notifications may clarify the retrospective dates (being the dates of trigger event) from which such restrictive condition applies. This will regularize the past positions adopted by the payers & payees and preempt any action by field authorities for past years either for recovery of shortfall of TDS and/or interest u/s. 201(1A) or 234B/C or s.220. It will also clear the ambiguity for future years. The CBDT can also issue a clarificatory Circular post issue of such Notification directing field authorities not to take any coercive action for past years.

While issuance of Notifications may take time, in the interests of taxpayer certainty, such intention of regularizing past transactions through a retrospective Notification may be communicated upfront with a view to clear the present uncertainty amongst taxpayers.

- It would provide certainty and transparency for both Indian and foreign entities involved in cross-border transactions and adopting such measures would reflect the government's commitment to fostering an equitable tax environment.

- The above would enable the taxpayer to mitigate the procedural issues with respect to imminent litigations and reduce consequential penalties.

5.5. Category B: Taxation of dividends on account of subsequent accession of third state to OECD

Issue:

- The second issue before SC was application of lower dividend withholding rates on dividends paid to residents of Netherlands, France and Switzerland based on MFN clause in those treaties and lower rates in treaties with Slovenia, Lithuania and Colombia which became OECD members subsequent to India signing treaties with them. The SC held that since Slovenia, Lithuania and Colombia were not members of OECD on date of signing treaties with India, the benefit of MFN clause linked to favourable treaty signed with OECD country cannot be granted. The SC reversed the Delhi HC rulings, illustratively, in the case of Concentrix Services Netherlands B.V. (2021) 434 ITR 516 (Del.) in this regard which were in favour of taxpayer.

- Based on favourable Delhi HC rulings, many Indian companies had granted benefit of lower dividend withholding tax rate to shareholders of countries with MFN clause. The adverse SC ruling will make them liable for recovery of TDS shortfall and interest u/s. 201(1A).

- Having regard to SC ruling, the Tax Department’s right to recover the shortfall of tax from the payer or payee cannot be disputed. However, the issue of concern for the payers and payees is levy of interest u/s. 201(1A) and initiation of penalty proceedings.

- In this regard, it is relevant to note that CBDT Circular No. 11/2017 dated 24 March 2017 provides for guidelines for waiver of interest u/s. 201(1A). Similarly, CBDT Order No. F No. 400/129/2002-IT(B) dated 26 June 2006 provides for guidelines for waiver of interest u/s. 234A/B/C. The hurdle in making applications for waiver of interest under these guidelines is that they provide relief only where the tax payment shortfall is attributable to favourable jurisdictional High Court ruling. Not all dividend paying companies may be covered by jurisdictional Delhi HC rulings which were in favour of the taxpayer.

However, there are decisions of Gujarat HC[3] wherein HC held that circumstances prescribed in CBDT order for interest waiver are illustrative and even in absence of jurisdictional HC ruling, the case is capable of being considered for waiver. For instance, in Devarsons (P.) Ltd. v. U.P. Singh [2006] 284 ITR 36 (Guj.), the position of non-taxability was taken in return of income on the basis of favourable ITAT decision in taxpayer's own case, which came to be overruled by a retrospective amendment, and HC granted waiver despite absence of favourable jurisdictional HC ruling in taxpayer's favour.

- Thus, the removal of condition of favourable jurisdictional HC ruling in the above referred guidelines for waiver of interest will remove any doubts in the minds of the field authorities to waive the interest for taxpayers outside the Delhi HC jurisdiction.

- The current Government has been very sensitive to India's image as an attractive investment decision not getting impacted by any adverse tax policy. Specific legislative amendments were brought in the income tax law in 2021 to provide for closure of pending litigation on retrospective amendments on indirect transfer. The above referred measures do not require any legislative amendment and can be easily implemented through Notifications and Circulars to be issued by CBDT. But it will bring out similar boost to India's investment image as the amicable closure of retrospective indirect transfer related controversy.

Recommendations:

- CBDT Circular No. 11/2017 dated 24 March 2017 and CBDT Order No. F No. 400/129/2002-IT(B) dated 26 June 2006 may be modified to remove the condition of existence of favourable jurisdictional HC ruling to avail waiver of interest u/s. 201(1A) and s.234A/B/C.

- To ensure seamless collection of tax demands, payers may be permitted to file a revised TDS return without payment of interest and penalties. Once right amount of TDS is paid as reflected in revised TDS return, payees may be absolved from further compliance or alternatively be permitted to file an updated return for all past AYs, without payment of additional taxes or interest and consequential immunity from penalty and prosecution. The payee may also be given an assurance that their assessments shall not be reopened on this account as long as the relevant taxes are deposited by the payers or by the payees themselves. For this purpose, a time limit up to 31st March 2025 may be provided to avail the benefit of automatic waiver of interest and penalty and immunity from initiation of reassessment proceedings.

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[3] Refer, Devarsons (P.) Ltd. v. U.P. Singh [2006] 284 ITR 36 (GUJ.) and Bhanuben Panchal and Chandrikaben Panchal [2004] 269 ITR 27 (Guj.)

Appendix A - List of benefits which can get impacted and DTAAs which can get impacted:

Nature of benefit for royalty/FTS	**DTAAs impacted**
Lower rate of 10% with respect to FTS/royalty income due to say India-Germany DTAA	Spain
Make available clause for FTS	France, Hungary, Sweden, Spain, Belgium
No equipment royalty pursuant to India-Sweden DTAA	Hungary, France, Spain

Interest related benefit	**DTAAs impacted**
Interest arising in India shall be exempt from tax if the same is paid by the Government or local authority of India virtue of India-Italy	Netherlands, France, Hungary, Sweden
India-Ireland/Denmark - restricts source country from taxing the interest on loan extended or **guaranteed or insured** by the Government, a political sub-division, a statutory body or a local authority	France, Hungary, Sweden

6. Annexure 6 - Making Safe harbours Attractive (particularly for GCC activities)

6.1. Background

To curb the increasing number of transfer pricing audits and prolonged disputes, the CBDT issued Safe Harbour Rules (SH Rules) in September 2013 and has periodically updated them thereafter. The SH Rules provide the circumstances in which tax authorities shall accept the transfer price declared by the taxpayer.

The honourable FM had announced in the last budget, that with a view to reduce litigation and provide certainty in international taxation, government will expand the scope of safe harbour rules and make them more attractive.

The suggestions for making safe harbours attractive are given below. Making safe harbours attractive will also help reduce the burden on Advance Pricing Agreements (APAs).

6.2. Issues of concern and suggestions

- SH Margins:

  The margins are as high as 18% for IT/ITeS sector, making the option of safe harbour unattractive. Government should rationalise the high margins - e.g., the margins for IT/ITeS can be reduced to 14-15%. This would be most useful for IT and ITeS sector and the Global Capability Centers (GCCs) who are playing a significant role in the Indian economy today[4]. Similarly, the margins of 24% for contract R&D in the generic pharma industry should be reduced significantly to encourage investment in this sector.

- Threshold value:

  As per current Safe Harbour Rules, a taxpayer cannot avail the benefit for eligible transaction if transaction value is more than INR 300 crore. The benefit of specified domestic transactions has been very limited, covering Government electricity companies and select co-operative societies.

  These revenue thresholds should be removed so that even the larger companies can avail the benefit.

- Sectoral scope:

  Currently, Safe Harbour Rules only cover manufacturing and export of core and non-core auto components. There are various other industries which are involved in manufacturing and exporting goods/components to associated enterprises, such as,

[4] EY expects the GCC market size to cross US$100b by the year 2030, with 4.5 million Total headcount

textiles, renewable energy, pharmaceuticals, components of medical devices, etc. which are not covered as part of the safe harbour rules.

Safe harbour rule should be extended to international transactions involving contract manufacturing and export of pharmaceutical products, investment advisory services, marketing support services, and captive research and development (R&D) services other than R&D in information technology (IT) etc. It may even be extended to banks, including foreign banks.

- Low value-added services:

  In respect of "low value-added services", the definition should align with that provided by Action 10 of the Base Erosion and Profit Shifting (BEPS) project of Organisation for Economic Co-operation and Development (OECD) and the prescribed rate should apply irrespective whether Indian party is receiving or rendering the services and not only where Indian party is receiving such services.

  Further, the scope of low value-added services is currently restricted to transaction value of INR 10cr. This scope should be expanded, and SH should be introduced even in case of provision of low value-added services at a markup of 5% itself.

- Corporate guarantee:

  Current rules provide a single corporate-guarantee fee of 1% p.a., irrespective of credit rating of Associated Enterprise where amount guaranteed is within INR 100cr, and irrespective of credit rating falling within adequate to highest safety where amount guaranteed exceeds INR 100cr.

  However, charging guarantee fee depends upon a lot of factors including amount guaranteed, purpose of borrowing, credit rating of borrower, impact of implicit support of Parent Group (shareholder function), etc. A general observation from the various tribunal decisions is that a corporate guarantee fee between 0.5% to 0.85% has been considered to be at arm's length.

  Over past 10 years, Government itself has entered into APA on Corporate Guarantee in more than 30 cases and thus the trend can be used to rationalise the fee basis credit ratings of borrower rather than blanket rate of 1% which is on a higher side.

- Interest on borrowings:

  Rationalise safe harbour rules for interest on borrowings as current margins are again on higher side.

- <u>TP Documentation:</u>

  Under the existing safe harbour rules, the taxpayer is required to undertake many TP documentation related compliances. To make it more attractive for small and medium industry players, requirement of maintaining TP documentation may be done away with in case the taxpayer applies for Safe Harbour and the same has been accepted by the tax authorities.

7. Annexure 7 - Expand transition of business losses and unabsorbed depreciation in Amalgamation for Service, Retail and other sectors

7.1. Background

- Provisions of s. 72A of the Act permit carry forward of business loss and accumulated depreciation for unexpired period in case of amalgamation only to certain specific types of companies such as those owning an industrial undertaking, banking companies, etc.

- Companies in the service or organized retail/trading sector are generally not eligible for such benefits.

- The services sector has been the bulwark of the Indian economy contributing about 55.3% of the total GVA in FY2025[6]. It has also attracted significant foreign investment totaling to more than 19.1% of the total FDI inflows into India. This sector also contributes significantly to India's exports wherein India's service exports amounted to 22% of the GVA in FY 2023. Further, it also provides employment to 29.7% of the workforce (compared to manufacturing sector's share at merely 11.4%).

- However, with the advent of globalization and liberalization resulting in the influx of foreign entities into India, the increasing competition has resulted in a pressing need for small companies in the service and organised retail/ trading to consolidate their resources to survive. Moreover, several service sector companies shall be looking for optimizing the operations by amalgamation with other companies even due to unprecedented Covid-19 situation and subsequent economic uncertainty resulting from various global disturbances/ wars and the US retaliatory tariffs.

- With growing emphasis on the digitization of economy and major portion of Indian GDP being contributed by service sector there seems to be no rationale for treating the service sector differently than manufacturing sector and restricting the applicability of s.72A only to manufacturing sector and select service sector.

- Even internationally, where transition of losses is permitted in major developed countries such as US, UK, Singapore or even developing countries such as China and Russia (which are members of BRICS), no such artificial distinction is made and transition of losses is permitted to companies in all sectors with the safeguards of continuity of business and/or continuity of ownership.

- While admittedly, safeguards to ensure continuity of business in case of manufacturing sector [in terms of achieving production of 50% of installed capacity

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[5] Ministry of Statistics and Programme Implementation (MOSPI)

[6] Source: Economic Survey 2024-25

and maintenance of 75% of assets post-merger] may not be feasible for service/ trading sector, safeguards inserted internationally may be illuminative:

- United Kingdom – Transition of losses to amalgamated company is subject to there being no scale down of business or change in its nature or ownership for 5 years subsequent to merger

- Singapore – Transition of losses to amalgamated company is permitted subject to shareholders holding 50% or more shares being the same and there being no break in continuity of the business

- Hong Kong – Transition of losses is to amalgamated company is subject to bona fides. Where sole/ dominant purpose is utilization of losses and there is change in the nature of business such losses are lost.

- China – Transition of losses to amalgamated company are permitted subject to satisfaction of the following conditions:

    - The amalgamation must have bona fide business purpose and must not be carried out with the primary objective of reducing, avoid or deferring tax payments.

    - At least 75% of equity interest in acquired company must be acquired in an equity acquisition or at least 75% of transferring company's assets must be acquired in an asset acquisition.

    - At least 85% of total consideration received must be in the form of shares.

    - There must be no change in the nature of activities for 12 months post amalgamation.

    - Shareholders holding atleast 20% of shares in the amalgamating company must continue to hold shares in amalgamated company for atleast 12 months post amalgamation.

➢ The extension of s.72A to service sector will enable tax efficient business reorganization of companies and thereby protect value for shareholders. It will enable stronger companies to absorb small/weak companies, protect jobs and also secure the interests of financial and operating creditors by avoiding liquidation of financially stressed companies. The revenue's interest can be protected by providing appropriate safeguard based on international precedence.

7.2. Recommendation

- Benefit of carry forward and set off of accumulated business loss and unabsorbed depreciation prescribed under s. 72A be extended to amalgamation of service and trading companies.

- Since the conditions relating to installed capacity may not be appropriate for all service sectors, different criterion may be introduced for service sector. Illustratively, and in addition to conditions specified under s. 2(1B), in the Indian context this may include:

    - Conditions for amalgamating company

        - Should be engaged in business in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years.

        - Should continuously hold as on date of amalgamation at least three-fourths of the book value of the fixed assets held by it two years prior to the date of amalgamation.

        - Should have a minimum number of average employee head-count (-say, 100 to 500) for two years prior to the date of amalgamation.

    - Conditions for amalgamated company

        - Should continue the business of the amalgamating company for minimum period of five years from the date of amalgamation with no scale down of operations (in the form of continuity of customers, suppliers, all business locations, markets, etc.) post-merger beyond specified limit (-say, 50%).

        - Should hold continuously for a minimum period of five years from the date of amalgamation at least three-fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation.

        - No fall in average employee head-count of employees for 3 years post-merger beyond specified limit (-say, 75%). For this purpose, Government may also consider some further conditions like qualifying employees who are enrolled in PF and/or have PAN/Aadhar numbers.

- The reporting requirement in Form No. 62 to be furnished by practicing CA for verifying claim made u/s. 72A may also be expanded to cover the employee related details which the Tax Department can cross verify using Digital technology with PF records, UIDAI’s Aadhar database, salary TDS returns, etc.