CVO CA UPDATES

CASE LAW UPDATE

Compiled by CA Jayna Shah

Palak Khatuja v. Union of India
[W.P.(T) No. 149 of 2021, order of Hon'ble Chhattisgarh High Court dated August 23, 2021]

M/s. Anant Rice Industries v. Union of India
[W.P.(T) No. 158 of 2021, order of Hon'ble Chhattisgarh High Court dated September 1, 2021]

❖ Summary

The Single-Judge Bench of the Hon'ble Chhattisgarh High Court upheld the validity of notices u/s. 148 of the Income-tax Act, 1961 ("the Act") issued after March 31, 2021 under the old regime for re-assessment proceedings without following the new procedures u/s. 148A effective from April 1, 2021

❖ Facts of the Case

- The Taxpayer had furnished Income Tax Return for FY 2014-15 (relevant to AY 2015-16)
- No additions were made during the original scrutiny assessment proceedings
- The Tax Department subsequently issued a notice u/s. 148 dated June 30, 2021 for re-opening of assessment proceedings for AY 2015-16
- The said notice was issued as per the old regime for re-assessment without following the new procedures specified u/s. 148A effective from April 1, 2021 requiring the Assessing Officer to conduct an enquiry giving an opportunity of hearing to the taxpayer with prior approval of specified authority and to issue a show cause notice in detail specifying particular date for hearing ("specified mandatory procedures")
- Consequently, the Taxpayer filed a Writ Petition before the High Court challenging the validity of said notice issued u/s. 148

❖ Taxpayer's Arguments

- The new regime for re-assessment proceedings came into force on April 1, 2021 wherein new Section 148A requires the Assessing Officer to follow specified mandatory procedures prior to issuing notice u/s. 148
- The notice u/s. 148 dated June 30, 2021 was issued following the old regime for re-assessment proceedings which was no longer on the Statute as on the date of issuance of such notice
- The notifications issued by the Ministry of Finance ("MOF") under the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act 2020 ("Relaxation Act") cannot extend the period of operation of the old regime for re-assessment proceedings once the said provisions were substituted with effect from April 1, 2021
- Hence, the Taxpayer contended that the notice u/s. 148 dated June 30, 2021 is illegal and liable to be quashed

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❖ Tax Department's Arguments

- Due to the pandemic and lock down of all activities including the normal working of offices, the taxpayers as well as Tax Department faced difficulties in ensuring timely completion of various compliances and procedures prescribed under the Act
- Accordingly, in exercise of powers granted under the Relaxation Act, the MOF issued notification no. 20/2021 dated March 31, 2021 and 38/2021 dated April 27, 2021 extending application of old regime for re-assessment proceedings initially up to April 30, 2021 and subsequently, up to June 30, 2021
- Consequently, the notice u/s. 148 dated June 30, 2021 is completely valid and legal

❖ Findings of the High Court

- Due to extended lockdowns imposed in the country to curb COVID-19 pandemic, the taxpayers and the Tax Department could not perform the necessary compliances/procedures under the Act in a timely manner. Hence, the Parliament enacted Relaxation Act to provide that any time limit specified or prescribed or notified under the Act between March 20, 2020 to December 31, 2021 (or such further date which may be notified by the Central Government) shall stand extended as specified under the Relaxation Act.
- Considering this complexity, the Parliament thought it is proper to delegate to the MOF to decide the date of applicability of the amended re-assessment provision. This delegation is not a self-contained and complete Act and is only been made in the interest of flexibility and smooth working of the law and out of practical necessity.
- The delegation of such power to the MOF can always be considered to be a sound basis for administrative efficiency and it does not by itself amount to abdication of power.
- A combined reading of notifications issued under the Relaxation Act dated March 31, 2021 and April 27, 2021 indicates that the re-assessment mechanism as prevalent as on March 31, 2021 was saved by the said notifications up to June 30, 2021 and the operation of the new regime for re-assessment was deferred up to that date
- It is a settled proposition that any modification by the Executive implies a certain amount of discretion which is to be exercised with the aid of the legislative policy of the Act and cannot travel beyond it and run counter to it or certainly change the essential features, the identity, structure or the policy of the Act. Therefore, this legislative delegation which is exercised by the Central Government by way of notifications to uphold the mechanism as prevailing prior to March 31, 2021 is not in conflict with any Act and the notifications issued by the Executive, i.e., the MOF would be a part of legislative function.

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- The High Court placed reliance on the judgement of the Hon'ble Supreme Court in the case of ***A. K. Roy v. Union of India [AIR 1982 SC 710]*** wherein it was held that the conferring of power on the Executive to bring provisions of an Act into force did not suffer from excessive delegation of legislative power and the power to issue a notification for bringing into force the provisions of a Constitutional Amendment is not a constituent (or essential) power, because it does not carry with it the power to amend the Constitution in any manner. The Legislature can resort to Conditional Legislation to give power to the Executive to decide in what circumstances the law should become operative or when the operation should be extended. Thus, in the instant case, the delegation of power to the Executive, i.e., the MOF, to specify the extended date for relaxation of time limits for various compliances/procedures under the Act does not defeat the main purpose of the Finance Act
- The High Court noted that the deferment of new Section 148A was done by the MOF by way of conditional legislation in the peculiar circumstances created due to the COVID-19 lockdown and accordingly, the Central Government cannot be said to have encroached upon the turf of Parliament
- Therefore, by effect of such notifications, the individual identity of Section 148 which was in force as on March 31, 2021 prior to the amendment was insulated and saved till June 30, 2021
- Considering the lockdown imposed due to COVID-19 pandemic, the time limits for various compliances/procedures were extended both for the taxpayers as well as the Tax Administration in parity and consequently, the old regime for re-assessment proceedings was also extended and saved up to June 30, 2021

❖ **Author's Comments**

The above decisions of the Hon'ble Chhattisgarh High Court do not consider the argument that the powers conferred by the Relaxation Act for extending limitation date for various compliances/procedures under the Income-tax Act, 1961 does not extend to deferral of operation of amendments made vide the Finance Act, which can be done only by Legislative amendment.

This is the first verdict on the validity of re-assessment notices issued u/s. 148 during the period April to June 2021 under the old regime without following the specified mandatory procedures u/s. 148A effective from April 1, 2021. In response to several Writ Petitions, the High Courts of Bombay, Gujarat, Delhi, Calcutta, etc. have granted an interim stay on similar notices issued u/s. 148 as per the old regime. Though the decision of the Hon'ble Chhattisgarh High Court may have persuasive value, it remains to be seen how the other High Courts would finally adjudicate on this issue.

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Compiled by CA Jayna Shah

Concentrix Services Netherlands B.V. v. ITO (TDS)
[2021] 434 ITR 516 (Delhi HC) dated April 22, 2021

❖ Summary

In the context of India-Netherlands Double Tax Avoidance Agreement ("DTAA"), the Hon'ble Delhi High Court held that the taxpayer is automatically entitled to lower withholding tax rate of 5% on dividends in view of application of the Most Favoured Nation ("MFN") clause in the Protocol appended to India-Netherlands DTAA

❖ Facts of the Case

- The Taxpayers were 2 Netherlands-based companies (Concentrix Services Netherlands BV and Optum Global Solutions International BV), and each had a subsidiary in India (99.99% shareholding), from which they received dividend income during the year
- The Taxpayers had applied to the concerned Tax Authority for seeking lower tax deduction certificate u/s. 197 at the rate of 5% on dividend income receivable from their Indian subsidiaries in view of the MFN Clause in the Protocol to India-Netherlands DTAA read with DTAAs entered into by India at a later date with OECD member countries namely, Slovenia, Lithuania and Columbia
- However, the Tax Authority rejected the application for lower tax deduction certificate on the basis that in absence of any specific notification to extend the benefit of lower tax rate of 5% to India-Netherlands DTAA, the same could not be applied automatically

❖ Taxpayer's Arguments

- The MFN clause in a DTAA entitles the eligible tax residents to adopt the beneficial treatment (by way of lower rate or restricted scope) accorded to a third country (OECD member country)
- By virtue of the MFN clause, one State binds itself to another State with respect to favorable treatment afforded by it in the future to a third State
- The MFN clauses in most of the Protocols appended to Indian DTAAs, including that of India-Netherlands DTAA, are self-operational which apply automatically without any requirement of a separate notification to this effect by the Government of both countries
- The Protocol contained in the India-Netherlands DTAA was configured, to self-trigger, upon the execution of a DTAA other than the subject DTAA, if it provided a lower rate of tax or a scope more restricted, as long as the deductee held more than 10% of the share capital of the deductor

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- In this context, for the purpose of application of lower tax rate of 5% on dividends earned from its Indian subsidiary, the Taxpayer placed reliance on DTAAs entered into by India with 3 other OECD member countries (after coming into force of Protocol in the India-Netherlands DTAA) namely, Slovenia, Lithuania and Columbia which limit the rate of tax on dividend income to 5%

❖ **Tax Department's Arguments**

- The benefit of the lower rate of withholding tax or a scope more restricted would extend to those governed by the subject DTAA (i.e., India-Netherlands DTAA in this case) if the DTAA(*s*) on which reliance is placed are entered into before the subject DTAA or with a country which was a member of the OECD on the date when the subject DTAA was executed
- Slovenia, Lithuania and Columbia were not OECD member countries on the date of entering into force of India-Netherlands DTAA and became OECD member countries only on a later date. Thus, MFN clause in Protocol to India-Netherlands DTAA has no applicability in the present case
- Further, Slovenia, Lithuania, and Columbia were not OECD member countries on the date when India executed DTAAs with these countries. Accordingly, the lower rate of withholding tax was extended to Slovenia, Lithuania, and Columbia in their own right and not because they were OECD member countries
- Additionally, no notification has been issued by the Governments of either India or Netherlands to give effect to the MFN Clause in the Protocol to India-Netherlands DTAA

❖ **Findings of the High Court**

The Hon'ble Delhi High Court held that the Taxpayers are entitled to concessional rate of 5% as per the MFN Clause in the Protocol to the India-Netherlands DTAA. The key factors as noted by the Court are summarized below:

- On a plain reading of the provisions of the subject DTAA and relying on a previous decision on this issue [Steria (India) Ltd [2016] 386 ITR 390], the Delhi High Court held that no separate notification is required to give effect to the lower tax rate under India's tax treaties with other OECD member countries, as the protocol providing for MFN clause forms an integral part of the subject DTAA

- The benefit of lower tax rate (or restricted scope) under India's tax treaty with a third country is to be allowed if (a) such third country is a member of the OECD and (b) the tax treaty with such third country provides for a tax rate lower or scope more restricted than the rate or scope under the Tax Treaty

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- The Court deliberated in detail on the Tax Department's argument that MFN clause should not apply as Slovenia / Lithuania / Columbia were neither OECD members at the time of execution of the India-Netherlands Tax Treaty nor at the time of execution of their respective tax treaties with India. Given the language of MFN clause which reads as *"If after the signature of this convention under any Convention or Agreement between India and a third State which is a member of the OECD India should limit its taxation at source on dividend…"*, the Tax Department's interpretation was that the third country should be an OECD member on the date of execution of the subject DTAA

- While the Court noted the emphasis laid by Tax Department on the term "is" used in the MFN clause, it held that that word "is" describes a state of affairs that exist on the date of claiming the benefit and not necessarily at the time the subject DTAA was executed.

- To address the debate that may arise on the interpretation of the term "is", the Court considered the intent of the other treaty partner, i.e., Netherlands as the best interpretative tool and referred to the decree issued by the Kingdom of Netherlands in the context of application of MFN clause. The decree inter alia referred to the fact that India has entered into a Tax Treaty with Slovenia on 17 February 2005 providing for a tax rate of 5% for dividend income (if recipient holds at least 10% of the share capital) and as Slovenia has become an OECD member on 21 July 2010, the said 5% tax rate would apply to the Tax Treaty with effect from 21 July 2010.

- The Court held that tax rate of 5% should be applicable from the date Slovenia became member of the OECD and emphasised that its approach aligns with the accepted principle of "Common Interpretation" of tax treaties (subject to circumstances)

❖ **Author's Comments**

Currently, while processing the TDS return in Form 27Q, the TRACES portal, by default, considers the applicable TDS rate as per the relevant Article of the DTAA without applying the benefit provided by the MFN clause in such DTAA thereby raising huge demands for alleged short deduction of TDS. This is a landmark judgement which provides useful guidance on automatic application of MFN clauses in India's Tax Treaties (for example, DTAAs entered into with France, Spain, Switzerland, etc.) to various streams of income such as dividends, interest, royalties and fees for technical services, which has been a subject matter of much debate and litigation.