MPC & CO LLP
CHARTERED ACCOUNTANTS

Corporate Update

March | 2025

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MPC & CO LLP
CHARTERED ACCOUNTANTS

FOREWORD

Dear Reader,

We are pleased to enclose our Corporate Update for the month of March, 2025 covering Summary of important decisions on Domestic and International taxation.

The Indian Economy is expected to have GDP growth of 6.5% during the current financial year 2025-26 inspite of turbulences being faced. India is now focusing on entering into Free Trade Agreements with various countries including UK, New Zealand, European Union etc. and an Agreement with United States on trade, tariffs.

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DIRECT TAXES

INTERNATIONAL TAXATION

CASE LAWS

Tribunal deletes adhoc attribution of income to the PE in absence of FAR analysis; holds no further attribution where transaction with PE is at arm's length

Fincantieri SPA Italiani SPA Trieste (TS) [TS-123-ITAT-2025(Mum)-TP] dated April 02, 2025

Recently, the Tax Tribunal, Mumbai bench held that where attribution of income to the permanent establishment ('PE'), being a project office, is at arm's length, no further attribution can be done. The Tribunal deleted 50% adhoc attribution made by the tax officer without any functions performed, assets employed and risks undertaken (FAR) analysis.

On facts, the taxpayer, Fincantieri SPA Italiani SPA Trieste (TS) is a tax resident of Italy and is engaged in the business of designing and construction of complex ships with high technological content. It entered into agreement with Mazagon Dock Shipbuilders Limited ('MDL') for provision of designs and drawings, review report and know-how for facilitating integrated construction of ships for the Indian Navy. The deliverables were prepared by the taxpayer in Italy basis the inputs from MDL. The taxpayer established a project office ('PO') in India to implement the agreement and provide required local support in connection with the project. The role of the PO was limited to providing requisite onsite technical assistance in understanding certain specific nuances of the drawings and designs and providing technical support required by customer in construction of ships. The PO in India was undisputedly a PE under Article 5 of the tax treaty between India and Italy.

In the tax return as filed by the taxpayer, it attributed approximately 13.5% of the revenue from MDL to the PO taxable on net basis @ 43.68% and balance 86.5% revenue was attributed to the Head Office taxable on gross basis @ 10.92% under the Act. The revenue as attributed to the PO was arrived at on the basis of FAR analysis conducted by the taxpayer. The taxpayer had adopted Transactional Net Margin Method and as per the Transfer Pricing ('TP') study report, the operating margin of 19.36% earned by the PO (on 13.5% revenue attributed to it) was higher than the arm's length range of margins of the comparable companies.

During the course of assessment, the taxpayer duly furnished details of activities undertaken by the PO and the Head Office under the contract with MDL and submitted that the PO had only limited role in the project. It was contended by the taxpayer that since the income attributable to the PO was calculated at arm's length principle, no further income could be attributed to the PO. The taxpayer placed reliance on the decisions of Hon'ble Supreme Court in the case of DIT vs. Morgan Stanley & Co. [292 ITR 416 (SC)] and Ishikawajma-Harima Heavy Industries Ltd. vs. DIT [158 Taxman 259 (SC)]. However, the tax officer attributed 50% of the total revenue to the PO on adhoc basis and only expenditure originally claimed by the taxpayer was allowed as deduction against such revenue. The DRP confirmed the addition as proposed by the tax officer.

On appeal before the Tax Tribunal, the taxpayer contended that significant portion of the contract has been undertaken by the taxpayer in Italy. It was argued that only eight employees were deputed to the PO and they were just graduates and not qualified enough to provide the deliverables envisaged under the contract with MDL. They simply acted as liaison between taxpayer and MDL.

The Tribunal noted that detailed TP study was conducted by the taxpayer and that no reference was made by the tax officer to the Transfer Pricing Officer ('TPO'). It further noted that the arm's length principle is embedded in Article 7 of the tax treaty, where income is to be attributed to the PE after considering functions of PE, assets deployed to the PE for carrying out the activity and risk assumed by the PE in performing its functions. The Tribunal held that the revenue from the aforesaid contract mostly pertained to the Head Office in Italy and only a limited attribution can be made to the PO i.e. PE. It was concluded that the international transaction pertaining to provision of technical consultancy services between PO and HO were undertaken at arm's length on the basis of Indian TP regulations and no further attribution could have been made to the PO on ad-hoc basis without carrying out FAR analysis.

The Tribunal also dealt in brief with the issue whether computation of income attributable to PE can be made by the tax officer without referring the matter to the TPO. The DRP had opined that that the tax officer was not empowered to refer the matter to the TPO for determination of Arm's Length Price in the present case. In this regard, the Tribunal noted that the TP provisions were applicable if there were transaction between two associated enterprises (AEs) and that PE is specifically included in the definition of enterprise. The Tribunal thus opined that the taxpayer (Head Office) and its PO in India would qualify as AEs and accordingly, TP principles were applicable. The Tribunal held that the PO in India was akin to a service provider to the AE in Italy and such services provided by PO in India to AE in Italy would qualify as international transaction. The Tribunal further observed that in terms of Article 7 of the tax treaty, PE is deemed as distinct and separate enterprise for the purpose of profit attributable to PE and the same needs to be determined in line with the arm's length principle. In this regard, the Tribunal placed reliance of the decision of Special Bench, Tax Tribunal, Ahmedabad Bench in the case of BEA Shenyang Transformer Group Company Ltd. [2024] 169 taxmann.com 145. It was thus concluded that TP provisions shall apply to the attribution of revenue between PO and its Head Office in Italy.

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Head Office Expenses attributable to Indian PE fully allowable as per pre-amended Article 7(3) of India-UAE DTAA, without applying restrictions imposed under Section 44C of the Act

Mashreq Bank PSC v Deputy Commissioner of Income Tax (International Taxation) [2025] 171 taxmann.com 230(Mum-Trib)

In a recent judgment, the Tax Tribunal, Mumbai Special bench held that Head Office expenses allocated to the Permanent Establishment ('PE') in India are fully allowable as per pre-amended Article 7(3) of the Double Taxation Avoidance Agreement between India and UAE ('DTAA'). As such, the provisions of Section 44C of the Act, which imposes certain restrictions on the admissibility of Head Office expenses, are not applicable while computing taxable PE profits for periods prior to the amendment of Article 7(3) the DTAA.

On the facts of the case, the Assessee, a UAE based banking company was running its business in India through its branches. For the AY 2002-03, the provisions of Article 7(3) of the DTAA were applicable (as it stood prior to its amendment by amending protocol dated 03-10-2007). Under Article 7(3) of the DTAA, as it stood at the relevant time, no restriction in respect of admissibility of executive and general administrative expenses had been stipulated.

During the course of the assessment proceedings for AY 2002-03, the Assessee claimed that in terms of the pre-amended Article 7(3) of the DTAA, all Head Office expenditure, including executive and administrative expenses, are allowable, without applying the restriction imposed under section 44C of the Act. However, the revenue denied the claim stating that Head Office expenses are allowable to the extent of 5% of average adjusted total income as per provisions of section 44C of the Act.

While doing so, the revenue also disallowed swift expenses and globus accounting software maintenance expenses incurred outside India, specifically for the Indian branches.

Before the Special Bench of the Tax Tribunal, the revenue relied upon Article 25 (Elimination of Double Taxation) of the DTAA which states that the domestic laws in force shall continue to govern the taxation of income. Based on such provision, the revenue argued that the restrictions in terms of Section 44C casted under the Act shall apply while computing PE profits.

However, the Tax Tribunal, Special Bench, did not agree with the interpretation of revenue. The Tax Tribunal, Special Bench held that the purpose of Article 25 of the DTAA is restricted only to the principles relating to grant of foreign tax credit in respect of income that has been subjected to double taxation. Moreover, the Tribunal noted that Article 25(1) of the DTAA does not apply where express provisions to the contrary are made in the Convention. Considering that Article 7(3) {as it stood at the relevant time} of the DTAA did not impose any restriction, Article 25(1) of the DTAA could not be pressed into service.

The protocol amending Article 7(3) of the DTAA was made effective from 01-04-2008 with prospective effect. The amended Article 7(3) of the DTAA was neither clarificatory nor intended to be made applicable with retrospective effect and, therefore, the bilateral amendment in Article 7(3) of the DTAA vide protocol clearly establishes that prior to amendment, intention of treaty partners was not to caste any restriction on allowability of expenses while computing PE profits.

Special Bench of a Tax Tribunal also clarified that whenever any amendment is intended to be given retrospective operation, it is explicitly stated so in the treaty. Hence, in absence of any such retrospective effect being given in Article 7(3) of the DTAA, such intention couldn't be inferred.

In view of the aforesaid, the Tax Tribunal, Special Bench held that all expenses attributable to the PE are fully admissible while computing PE profits, without any regard to Section 44C of the Act.

Based on the above conclusion, the Tax Tribunal, Special Bench held that the issue of allowability of swift expenses and globus accounting software maintenance expenses did not require separate adjudication. Nevertheless, for the sake of academic discussion, the Tribunal did hold that said expenses were directly related to the Indian Branches and hence, were allowable under section 37 of the Act in view of the decision of the Bombay High Court in cases of *DIT(IT) v Credit Agricole Indosuez [2016] 69 taxmann.com 285 and DIT (IT) -I v American Express Bank Ltd. [IT Appeal No. 1294 of 2013, dated 1-4-2015].* As such, the provisions of Section 44C of the Act had no application in this case.

The Appeal was accordingly decided against the Revenue and in favour of the assessee.

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DOMESTIC TAXATION

CASE LAWS

Intimation under section 143(1) merges with assessment order under section 143(3) if the adjustments made under section 143(1) are incorporated in the assessment order

In a recent decision in the case of **Deputy Commissioner of Income Tax Vs Aditya Birla Housing Finance Limited [TS-239-ITAT-20259(Mum)],** the ITAT, Mumbai has held that when the adjustments made under section 143(1) while processing the return of income have been incorporated in the assessment order under section 143(3), the intimation under section 143(1) shall stand merged with the assessment order under section 143(3).

In the instant case, the assessee, a Housing Finance Company filed its return of income for AY 2021-22 on 15.03.2022. The case of the assessee was selected for scrutiny assessment under section 143(2) vide notice dated 28.06.2022. Thereafter, intimation under Section 143(1) of the Act was issued on 25.10.2022 regarding processing of return of income.

In the intimation under section 143(1), certain adjustments/variations were made to the returned income. The assessee did not prefer appeal against the aforesaid intimation under Section 143(1) of the Act since the regular assessment proceedings were already initiated.

The regular assessment proceedings culminated into passing of the Assessment Order, dated 29.12.2022, under Section 143(3) read with Section 144B of the Act, where no addition/disallowance was proposed. However, in the computation sheet forming part of assessment order, the adjustments made under section 143(1) were incorporated.

Aggrieved, the assessee filed an appeal before CIT(A) against the order under section 143(3) challenging the variation/adjustment made in intimation under section 143(1) as incorporated in the assessment order. The CIT(A) allowed the grounds as raised by the assessee and granted relief inter alia, by (a) deleting the disallowance of Rs.1,67,98,699/- made under Section 43B of the Act on account of leave encashment (b) deleting the disallowance of Rs.5,87,81,517/- made under Section 43B of the Act on account of employee bonus/commission (c) deleting the adjustment made on account of Income Computation and Disclosure Standards (ICDS) amounting to Rs.2,27,82,861/- (d) granting credit of Tax Deducted at Source

(TDS) of Rs.1,90,121/- and (e) granting additional credit of TDS of Rs.29,30,368/- reflected in updated Form 26AS.

Aggrieved, the department filed an appeal before the ITAT challenging the above relief to the assessee.

The department contended that intimation under section 143(1) is an appealable order and therefore, the assessee ought to have filed appeal against the same before CIT(A). As no such appeal was filed, the assessee was precluded from raising grounds challenging the adjustments made under section 143(1).

The assessee contended that the intimation issued under section 143(1) of the Act stands merged with the order passed under section 143(3) of the Act and therefore, the assessee could have challenged the adjustment/addition made in intimation under section 143(1) of the Act only in appeal preferred against the assessment order passed under Section 143(3) of the Act.

It was further contented that the Assessing Officer had incorporated the adjustment/addition made in the intimation order issued under section 143(1) in the computation sheet attached to assessment order, which formed part of the assessment order. Therefore, the adjustment/addition stood incorporated in the assessment order passed under section 143(3) and consequently, appealable before the CIT(A).

The ITAT examining the legislative history of section 143(1) held that section 143(1) before its amendment/substitution by the Finance Act, 2008 did not contain provision for correcting arithmetical mistakes or internal inconsistencies. This resulted in avoidable revenue loss. With the objective of reducing the aforesaid revenue loss, the former section 143(1) was substituted by a new section 143(1) which provided for computation of total income after making the specified adjustments for arithmetical errors or incorrect claim. Thus, the scope of newly substituted section 143(1) was limited to the aforesaid adjustments. On the other hand, the scope of regular scrutiny assessment under section 143(3) of the Act continued to be much wider than section 143(1). Further, there is no provision which prohibits the processing of return of income under section 143(1) of the Act in case notice for scrutiny assessment under section 143(2) of the Act has been issued. Thus, under the scheme of the adjustment/assessment as contained in section 143 of the Act, for a single assessment year there can be an intimation issued under section 143(1) of the Act as well as an order of assessment passed under section 143(3) of the Act. The ld. ITAT, therefore, rejected the contention of the assessee that there cannot be two orders appealable before ld. CIT(A) for the same assessment year.

The ITAT further held that the view that intimation issued by under section 143(1) stands merged with the assessment order might have held good for the former section 143(1) [effective from 10/06/1999 to 31/03/2008], the same did not hold good in all cases where intimation is issued under section 143(1) of the Act as substituted by the Finance Act, 2008 [effective from 01/04/2008]. Therefore, after the substitution of 143(1) of the Act by way of Finance Act 2008, the applicability of doctrine of merger in respect of intimation issued under Section 143(1) of the Act with order passed under Section 143(3) of the Act would depend upon the facts and circumstances of each case and would be limited to the commonality of subject matter of adjustment. However, the ITAT accepted that in the facts and circumstances of the present case, the doctrine of merger would apply as the AO has incorporated the adjustments under section 143(1) in the assessment order. Therefore, such adjustments would be appealable before the CIT(A).

Based on the above observations, the ITAT remanded back the adjustments under section 143(1) to the file of the AO with the directions to decide the same afresh after granting the assessee a reasonable opportunity of being heard, as the CIT(A) had not recorded his reasoning for allowing the said claim.

As regards the challenge regarding granting of TDS credit that was reflected in Form 26AS but was not claimed by the assessee in the return of income, the ITAT held that such claim of TDS may be considered as additional claim made before the CIT(A). The ITAT, remanding the matter to the AO for verification of corresponding income, directed the assessee to file a statement showing reconciliation statement in support of the contention that the additional TDS credit claimed pertains to income already offered to tax.

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Satisfaction of conditions for availing immunity from penalty u/s 271AAA on a certain sum of undisclosed income for reduction of the amount of penalty

Recently, the Supreme Court of India in the case of **K. Krishnamurthy v DCIT ([2025] 171 taxmann.com 413 (SC))** has held that levy of penalty under section 271AAA of the Act is not required to be made on the entire sum of undisclosed income as per assessment order if the assessee is able to satisfy the three conditions for exemption from penalty on a certain part of the undisclosed income as provided in sub-section (2) of Section 271AAA, as under:

1. the assessee admits the undisclosed income in a statement under section 132(4) of the Act in the course of search and specifies the manner in which such income has been derived;
2. the assessee substantiates the manner in which the undisclosed income was derived; and
3. the assessee pays the tax, together with interest, if any, in respect of the undisclosed income.

The assessee was a resident individual, a real estate broker, whose premises was searched under Section 132 of the Act on 25 November 2010. During the course of search, the assessee admitted undisclosed income of Rs.22.77 million in a statement under section 132(4) of the Act and specified as well as substantiated the manner in which such income was derived. The assessee also paid tax along with interest on such undisclosed income although with a delay.

In the course of assessment post search, the assessee had filed his return for AY 2011-12 in response to a notice u/s 142(1) of the Act by declaring a total income of Rs. 47.71 million by suo-motu including another Rs. 24.94 million as other income. The total income of the assessee was assessed at Rs. 47.71 million and an order imposing penalty on entire income of Rs. 47.71 million was passed. The assessee filed appeal against penalty order before the CIT (Appeal) who rejected the appeal on the ground of non-compliance with the exemption conditions as prescribed under section 271AAA(2) of the Act. The Tribunal also rejected the appeal. Upon further appeal, the Hon'ble Karnataka High Court held that the compliance of all three exemption conditions of section 271AAA(2) of the Act are mandatory and that reduction of penalty commensurate with quantum of tax on income accepted on search proceedings cannot be allowed. Upon further appeal, the case was admitted before the Supreme Court on the question of law regarding reduction of penalty commensurate with quantum of tax which the assessee had deposited.

Supreme Court observed that a penalty provision has to be strictly construed as section 271AAA(1) uses the phrase '**may**' for levy of penalty and hence, imposition of penalty is not mandatory but discretionary.

In view of the above, the Supreme Court held that as all the conditions with respect to obtaining immunity from levy of penalty under section 271AAA(2) were satisfied for the part sum of Rs.22.77 million, hence, penalty is to be levied only on the balance amount of Rs. 24.94 million (i.e. Rs. 47.71 million less Rs. 22.77 million). Hence, the Supreme Court allowed for a split of income for the purpose of levy of penalty and did not penalise the assessee for the entire sum.

MPCO's critical analysis:
Notes:

1. ***The Section 271AAA is not relevant now, as it has outlived its effect after July 1, 2012, except for pending proceedings, if any.***
2. ***For the same, reason as in Note 1 above, the Income-tax Bill, 2025 does not have any corresponding provision.***
3. ***Even though the decision in the above judgment is under S-271AAA, which seems to be a stand-alone provision, because of the non-obstante provision contained in sub-section (1) thereto, the ratio of the above judgment can be viewed positively by the taxpayers in penalty proceedings under various other provisions of the Act for partial grant of immunity from penalty where exemption conditions for levy of penalty may be fulfilled for a part sum.***

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Annual Value of House Property vacant for the whole year is Nil in case where property let out in earlier period and remained vacant for the whole year during the assessment year, showing the intention of the assessee

Classic Mall Development Company Ltd. [2025] 173 taxmann.com 94 (Mumbai - Trib.)

The Mumbai bench of Income-tax Appellate Tribunal ('Mumbai ITAT') has held that the intent to let out, rather than actual letting out of a property, is essential to allow loss due to vacancy and therefore, annual value of such property shall be Nil.

In the instant case, the Assessee was engaged in development of malls, multiplexes etc. During FY 2015-16, the Assessee was unable to let out few units of the mall and hence, no rental income was offered to tax in respect of these units. The Assessing Officer ('AO') computed annual value of these units on the basis of expected reasonable rate under Section 23(1)(a) of the Income-tax Act, 1961 ('Act') and made addition to the total income of the Assessee. The AO relied upon the decision of High Court of Andhra Pradesh in the case of *Vivek Jain v. ACIT [2011] 337 ITR 74 (Andhra Pradesh)*, wherein, it was held that if property is not let out then notional income has to be shown.

As the Commissioner (Appeals) upheld the additions made by the Assessing officer, the Assessee company filed an appeal before the Mumbai ITAT for relief.

During the course of hearing, the Mumbai ITAT noted that the provisions of Section 23(1)(c) of the Act were introduced by Finance Act 2001 to grant deductions in computing annual value of a property on account of vacancy and unrealized rent where property could not be let out for whole year. Therefore, the clause (c) has been inserted as a protection to the assessee in cases where, on account of vacancy, the rent of a let-out property is less than the sum referred to in clause (a). Prior to such amendment, vacancy allowance was available in case of only those properties which remained vacant for part of the year.

The Mumbai ITAT also noted that the provisions of Section 23(1)(c) of the Act contains the situation where property is let and is vacant for whole year, a situation which cannot arise simultaneously. Applying the principles of purposive construction, the Mumbai ITAT observed that the term 'vacant for the whole year' covers the situation where intent to let out at the end of the Assessee has to be considered by the Revenue and as such, the term 'let' shall be read as 'intended/ available to let'. In the instant case, the Assessee demonstrated that the relevant units of the mall were let out by the Assessee in other years.

During the course of hearing, the Assessee pointed out that the decision of High Court of Andhra Pradesh relied by the AO is not binding on the jurisdictional Tribunal as it was rendered by a non-jurisdictional Court. To support its contention, the Assessee relied upon certain judicial pronouncements of High Court of Bombay. Furthermore, the Assessee submitted that the decision of High Court of Andhra Pradesh covered those cases where property was vacant for part of the year and same cannot be extended to a situation where property could not be let out at all. In this regard, the Assessee placed reliance on the decision of Mumbai ITAT in the case of *Sonu Realtors Pvt. Ltd. v. DCIT in ITA No. 2892/Mum/2016*, wherein, the decision of High Court of Andhra Pradesh was distinguished on the same line.

The Assessee further relied upon the decision of the Mumbai ITAT in ITA No. 241 and 242/Mum/2015 in which Revenue's assumption that the properties were not intended to be let out was held to be erroneous one.

The Mumbai ITAT agreed with the contentions of the Assessee and held that the annual value of a vacant property of the Assessee shall be computed in accordance with the conditions prescribed in clause (c) to section 23(1), when compared with sum referred to in clause (a). Accordingly, the Mumbai ITAT concluded that under the deeming provision of section 23(1)(c), in the case of a property which is vacant for whole of the year, its annual value shall be taken at 'Nil'.

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CIRCULAR

CBDT Circular No.5/2025 dated March 28, 2025 - Waiver on levy of interest under section 201(1A)(ii) or 206C(7) in specific cases

Section 201(1A)(ii) and Section 206C(7) of the Act provides for levy of interest on account of failure to pay the Tax Deducted at Source (TDS) and Tax Collected at Source (TCS) to the credit of the Central Government by the deductor/collector in due time.

Due to some technical glitches of non-credit of TDS/TCS by government although interest payment was debited from taxpayer bank account, notices were issued to taxpayers for interest on late payment of taxes.

Upon representation, CBDT has issued instructions to the income tax authorities vide circular no 5/2025 dated March 28, 2025 to waive interest under section 201(1A)(ii) or section 206C(7) in genuine cases where payment of TDS/TCS is debited from the bank accounts of the tax payer on or before the due date and the tax could not be credited to the Government before the due date because of technical problems, beyond the control of the tax payer.

In such cases, the tax payer would be required to make an application to the income tax authorities for waiver of interest within one year from the end of the financial year for which such interest is charged. The income tax authorities would be required to dispose off the application for waiver of interest within a period of six months from the end of the month in which such application is received.

After thorough verification of technical glitches from the bank/Directorate of Systems and providing sufficient opportunity of being heard, the income tax authorities would be required to pass a speaking order. The order accepting or rejecting the waiver of interest would be final and no further petition against the order would be considered by CBDT. In case waiver is ordered, then the interest already paid would be refunded.

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