Tax Matters

Issue No. 2024/11 Date: 6 December 2024

The team at JMP Advisors is pleased to bring to you a gist of some of the significant developments in the direct tax space during November 2024:

Income tax rulings

- **Indexed cost of interest on borrowed funds for purchase of house property allowed as deduction for computing Long Term Capital Gains**

  - DCIT (3)(2)(1) vs Mr. Neville Tuli[1]

The taxpayer, an individual, sold a house property which was purchased using borrowed funds. The taxpayer filed a Return of Income ('ROI') for the Financial Year ('FY') 2012-13 and offered to tax the amount of long-term capital gain ('LTCG') by deducting indexed cost of acquisition ('COA') and indexed cost of interest paid to bank as indexed cost of improvement ('COI'). The taxpayer had claimed the deduction of INR 1.5 Lac under section 24(b) of the Income Tax Act, 1961 ('The Act') and the balance of the interest paid on borrowed funds (over and above INR 1.5 Lac) amount was claimed as COI.

During the course of scrutiny, the tax officer referred to section 55 of the Act for amount claimed as deduction under COI. The tax officer held that COA should not include any cost incurred after the date of acquisition, unless any COI is incurred in the property. The interest payment on housing loan cannot be said to be expenditure of a capital nature incurred in making any additions or alterations to the capital asset after it became his property unless actual improvements are made. Thus, the indexed COI was disallowed and added back to the income of the taxpayer as LTCG.

The taxpayer filed an appeal with the Commissioner of Income-tax (Appeals) ('CIT(A)'). The CIT(A) observed that the taxpayer had claimed the deduction of INR 1.5 Lac under section 24(b) of the Act in earlier years.

The CIT(A) mentioned that sections 48,49 and 55 of the Act do not provide clarity about allowability of interest paid on housing loan as part of COA in computing the LTCG. The CIT(A) has referred to contrary judgements by the Tribunals and the High Courts on allowability of interest deduction under Section 48 as COA. The taxpayer relied on the decision of jurisdictional Tribunal in the case of Shri Fritz D. Silva[2] where the decision was in favour of taxpayer on an identical issue. The CIT(A) referred to a proviso[3] inserted by Finance Act 2023

---

[1] ITA No. 3203/2023/Mumbai Tribunal

[2] ITA No. 236/Mum/2010

[3] Provided that the cost of acquisition of the asset or cost of improvement thereto shall not include the deductions claimed on the amount of interest under clause (b) of section 24 or under the provisions of Chapter VIA.

under clause (ii) of section 48 which is applicable from 01 April 2024, whereby it is provided that the COA of the asset or the COI shall not include the deductions claimed on the account of interest under section 24(b) or under the provisions of Chapter VI-A. The CIT(A) opined that prior to insertion of amendment, there was no provision restricting the deduction claimed on account of interest paid under section 24(b) or under the provisions of chapter VIA of the Act and thus, held that the amendment is not clarificatory in nature, therefore cannot be applied retrospectively. Accordingly, the taxpayer's claim was allowed.

The tax authorities preferred an appeal before the Mumbai Tribunal. The Tribunal observed that the deduction to the extent of INR 1.5 Lac only was claimed by the taxpayer and rest of the amount was claimed as indexed COI. Thus, the Tribunal opined that taxpayer has not claimed any double deduction. Further, Tribunal observed that the taxpayer has consistently claimed similar deduction as interest expenditure under the income from house property and as COA/COI in earlier years i.e. FY 2010-11 and FY 2011-12 which has been continuously allowed by the tax authorities. The Tribunal also relied on the Supreme Court judgment in case of Vegetable Products[4], wherein it was held that if two reasonable constructions of a taxing provision are possible, then the construction which favours the taxpayers must be adopted. Further, reliance was placed on the Delhi High Court judgment in case of Mithlesh Kumari[5] wherein it was held that interest paid on the borrowed funds for the purchase of property constitutes part of the actual cost for determining capital gains.

Therefore, the Tribunal upheld the view of the CIT(A) and allowed the deduction of interest paid on the borrowed funds for the purchase of property while computing LTCG.

JMP Insights – *This decision underscores the principle that an expense/deduction can be claimed under multiple provisions of law, unless explicitly excluded. Though the decision is favourable for taxpayers, a crucial question remains whether interest costs incurred on borrowed funds will be permissible as COA/COI while computing capital gains. As per section 55, COI includes expenditure of a capital nature incurred in making any additions or alterations to the capital asset. However, as per the accounting standards, financing costs are capitalized till the asset is put to use and then considered as a revenue expense.*

- **Income earned by airlines in international traffic through code sharing agreement eligible for benefit under India USA Tax Treaty.**

  - Delta Air Lines Inc vs ACIT[6]

The taxpayer is a foreign airline company engaged in the business of operating aircraft in international traffic. The taxpayer is a resident of USA. The taxpayer had established a branch office in India for passenger ticket bookings and air freight bookings with the approval of the Reserve Bank of India ('RBI'). Accordingly, the branch office was a Permanent Establishment ('PE') of the taxpayer in India. The income of the taxpayer consisted of:

(i) transportation entirely through its own aircraft

[4] 88 ITR 192 (SC)
[5] 92 ITR 9 (Delhi HC)
[6] I.T.A. No.235/Mum/2022

(ii) transportation partly through its own aircraft and partly through third-party aircraft under a Code-Sharing Agreement ('CSA')[7] under a single ticket for the entire journey in international traffic

(iii) transportation entirely through third-party aircraft under a CSA.

The taxpayer claimed the benefit under Article 8 of the India-USA Double Tax Avoidance Agreement ('India USA DTAA') and filed a 'NIL' ROI. The tax officer denied the benefit on the income earned under CSA with third parties. As per the tax officer the taxpayer had only booked the tickets and the actual transportation was done by the third parties. In order to claim benefit under Article 8 of India USA DTAA the crucial test for eligibility is that profit should be derived from operation of aircraft in international traffic by the ship or aircraft owned/leased/chartered by the taxpayer. The tax officer applied the Global Profitability Rate and computed the taxpayer's income as per Rule 10 of the Income-tax Rules. The Dispute Resolution Panel upheld the tax officer's view.

The taxpayer filed an appeal with Mumbai Tribunal. The tax authorities contended that the issue was covered in the taxpayer's own case by the adverse decision of the coordinate bench in earlier years and thus binding on the taxpayer. The tax authorities had argued that income from such operations cannot be termed as profits earned from operation of aircraft.

The taxpayer submitted that the decision by the Bombay High Court ('Bombay HC') in the case of Balaji Shipping UK Ltd[8] laid down that the slot charter agreements are inextricably linked with shipping business. This is in line with the taxpayer's contention that profits from third-party carriers under a CSA are earned from operating aircraft in international traffic. The ruling of Bombay HC in case of Balaji Shipping UK Ltd was pronounced after the taxpayer's case in past year.

The taxpayer submitted details linking other airlines' flights to their operations under CSA. The tribunal referred to the ruling in case of Balaji Shipping UK Ltd and APL Co Pte Ltd[9] which interpreted "chartering" receipts under slot chartering agreements as being directly linked to the enterprise's main business, making them eligible for benefit under the relevant DTAA.

The tax authorities argued that under CSA, aircraft were operated by third parties and do not fall under Article 8 of India USA DTAA. The Tribunal ruled that under CSA, the taxpayer issued tickets using unique codes for the entire journey. The Tribunal noted that under CSA, third-party airlines are responsible for transporting taxpayer's passengers to their destinations when tickets are booked under these unique codes. Thus, this income would be linked to the main business of aircraft operations.

The Tribunal referred to the OECD model commentary and US model convention which included slot chartering/CSA while interpreting the eligibility of the taxpayer to avail the India USA DTAA.

---

[7] CSA is an arrangement in which one air carrier puts its designator code on the flight of another carrier which allows one air carrier to hold itself out as providing service in markets where it does not otherwise operate or in segments where it operates infrequently.

[8] 24 taxmann.com 229 (Bombay)

[9] [2016] 75 taxmann.com 32 (Bombay)

The Tribunal held that income earned from third-party airlines under CSA is not taxable in India, as it is covered under Article 8 of the India USA DTAA.

JMP Insights – *This decision highlights the importance of interpretation of treaties with relevant commentaries and consistently applying the ratio laid down in rulings on similar issues. This decision emphasises that exemption is available under Article 8 of India USA DTAA if there is a direct nexus with the main business even without direct ownership or lease of aircraft.*

- **Taxpayers eligible for beneficial provisions of domestic tax and DTAA provisions to separate streams of income**

  - Morgan Stanley Mauritius Company Limited vs DCIT (International Taxation)[10]

The taxpayer is a tax resident of Mauritius and registered as Foreign Portfolio Investor ('FPI') under Security Exchange Board of India ('SEBI'), to carry out portfolio investment activities in Indian securities. During FY 2019-20, the taxpayer earned capital gains income from its investment in Indian securities.

The taxpayer filed a ROI declaring income of INR 474.94 million which included income from other sources. The taxpayer had shown net LTCG arising from the alienation of shares acquired before 1 April 2017. The said LTCG was claimed as exempt from tax in India under Article 13(4) of the India-Mauritius DTAA. Further, in ROI, carry forward of short-term capital loss ('STCL') of INR 8,855.25 from earlier years i.e. FY 2012-13 and FY 2015-16 was shown. The ROI for STCL in the respective years was filed under the provisions of the Act being more beneficial than India Mauritius DTAA. The STCL was not utilised in the current FY and was carried forward to subsequent FYs.

The tax officer argued that the taxpayer was not entitled to carry forward STCL as the loss was not taxable in India due to the provision of India Mauritius DTAA. The tax officer also contended that gains derived by a resident under Article 13 of India Mauritius DTAA from alienation of any property in securities before 1 April 2017 are taxable only in the resident state, and non-taxable foreign income should not be used for loss set-off. The tax officer argued that taxpayer cannot selectively use India Mauritius DTAA benefits for LTCG and carry forward STCL.

The taxpayer argued that they could choose beneficial provisions of the Act or India Mauritius DTAA in different years, each year being independent. The taxpayer claimed exemption under Article 13(4) of DTAA and carried forward losses without setting them off against non-taxable income. However, in view of the above arguments and Section 74(1), the tax officer disallowed carried forward of STCL to subsequent years.

The taxpayer filed an appeal before the Tribunal. The Tribunal referred to section 74 of the Act and stated that if the computation under the head 'capital gain' is a loss, then whole of such loss is to be carry forward to the following years for set off against STCG or LTCG. And the remaining loss after set off, shall be carried forward to the following years. The Tribunal relied on various judicial precedents of co-ordinate benches referred to by the taxpayer:

[10] ITA No. 3316/MUM/2023

i) In the case of Credit Suisse (Singapore) Co. (Mauritius) Ltd.[11], the Tribunal upheld the theory of segregation of capital gains and capital losses from different sources of income under the head 'capital gains' to claim the benefits of DTAA/provisions of the Act as the case may be whichever is more beneficial to the taxpayer as per section 90(2) of the Act.

ii) In the case of Indium IV (Mauritius) Holding Ltd.[12], wherein it was held that income arising from a separate stream of income has to be treated separately. The provisions of section 90(2) of the Act will apply to each stream of income and not the head of income. Therefore, different treatment could be sought by the taxpayer for the LTCG arising in the year under consideration and STCL which has been brought forward from the earlier years.

The Tribunal ruled that taxpayers can choose beneficial provisions of the DTAA for LTCG earned during FY and carry forward STCL to subsequent years without setting off against LTCG.

JMP Insights – *This decision brings clarity that section 90(2) applies to each stream of income separately and not to the head of income. This decision signifies that taxpayers can selectively apply provisions of the DTAA and the Act to maximize tax benefits.*

- **Routine repairs and maintenance do not qualify as Fees for Technical Services**

  - Rockwell Collins Southeast Asia Pte Ltd vs Deputy Commissioner of Income Tax[13]

The taxpayer is a company established under the laws of Singapore and a resident of Singapore. The taxpayer's primary business is to offer aircraft repair and maintenance services. The equipment is shipped outside India, where repairs are done and returned to Indian customers. The taxpayer earns revenue of INR 127.86 million from Indian customers ('customers'). The taxpayer had filed a NIL ROI for the FY 2019-20 claiming a refund of INR 7.60 million. The taxpayer's ROI was selected for assessment.

The tax officer characterised the payment received by the taxpayer for aircraft repair services as Fee for Technical Services ('FTS)' under both section 9(1)(vii) of the Act and the India-Singapore DTAA. The taxpayer argued that the services were performed outside India and provided through an automated process, involving special knowledge. Thus, the receipts are not taxable in India. The tax officer emphasized that the location of service delivery is irrelevant if the services benefit a business in India. The tax officer cited the Supreme Court ruling in GVK Industries[14] and highlighted that repairs made are provided to customers for independent use. The tax officer argued that in addition to the repair and maintenance agreement, the taxpayer and its customers also exchange proprietary information. Further, restrictions are placed on both parties to prevent the use of data received which denotes that technical know-how and information is being 'made available' to the customers.

---

[11] ITA No. 1107 and 1108/Mum/2022
[12] ITA No. 2423/Mum/2022
[13] ITA No. 2409/Del/2023
[14] 332 ITR 130 (SC)

The taxpayer argued that the income earned is not FTS as per Explanation 2 to Section 9(1)(vii) of the Act. These services are routine maintenance services and not technical services as per the Act. The taxpayer also argued that it should not be construed as FTS under India Singapore DTAA as it does not 'make available' technical knowledge to enable the end user to use the same by its own. The taxpayer relied on Delhi Tribunal ruling in the case of Global Vectra Helicorp Ltd[15] wherein it was held that since the entire repairs and maintenance of helicopter parts was carried out outside India and nothing was done in India, the payment in the nature of repair and maintenance services is not chargeable to tax in India in the hands of the non- resident. Various other rulings were also relied upon by the taxpayer.

Further, the taxpayer argued that it has no PE in India. The taxpayer submitted that these services may fall under the category of works contract by relying on Mumbai Tribunal's ruling in case of DHL Air Ltd[16] wherein it was held that repairs and maintenance of aircraft cannot be termed as technical services as defined in section 9(1)(vii) of the Act and rather it falls under the category of works contract as per section 194C of the Act. This is also clarified by CBDT in its Circular No. 715 dated 08 August 1995 vide Question No. 29. Hence, the payment received would not be taxable in India. However, the tax officer considered receipts as FTS under the Act as well as under India Singapore DTAA.

The Delhi Tribunal held that there was neither transfer of any technology, technical plan or design nor any technical knowledge was made available that would enable the customers to carry out repairs on their own without the assistance of the taxpayer. So, the services rendered do not fulfil the 'make available' clause under Article 12 of India Singapore DTAA. The Tribunal relied on the ruling given by the coordinate bench in case of Goodrich Corporation[17] which is a sister concern of the taxpayer and was based on similar facts, wherein it was held that the services do not qualify as FTS. Thus, the tribunal held that the services provided by the taxpayer do not qualify as FTS under the act as well as India Singapore DTAA.

JMP Insights – *The place where the services are performed is crucial in determining taxability. Careful assessment of the nature of services is required to determine whether the services qualify as FTS. Routine repairs and maintenance do not constitute FTS under the DTAA since there is no imparting of knowledge or skill to the recipient.*

RBI Circular No. 19 of FY 2024-25 dated 11 November 2024

- **Operational framework for reclassification of Foreign Portfolio Investment to Foreign Direct Investment**

The RBI introduced a streamlined operational framework to allow FPI to reclassify their investments to foreign direct investment ('FDI') when equity holdings in Indian companies surpass the prescribed 10% limit of the total paid-up equity capital on a fully diluted basis.

As per Schedule II of Foreign Exchange Management (Non-Debt Instrument) Rules, 2019, any FPI investing in breach of the prescribed limit shall have the option of divesting their

[15] 159 taxmann.com 282 (Del Trib)
[16] 86 taxmann.com 277 (Mum Trib)
[17] ITA No. 988/Del/2024

holdings or reclassifying such holdings as FDI subject to the conditions specified by the RBI and SEBI, within five trading days from the date of settlement of the trades causing the breach.

Operational framework for reclassification:

1. Obtaining approvals

- The FPI concerned shall obtain the necessary approvals from the Government and concurrence of the Indian investee company before intending to acquire equity instruments beyond the prescribed limit to ensure adherence to the FDI provisions.

2. Submission to Custodian

- The FPI is required to intimate its intent to reclassify existing FPI held in a company into FDI and shall provide the copy of the necessary approvals and concurrence to its Custodian. Custodian will freeze the purchase transactions by such FPI in equity instruments of such Indian company, till completion of the reclassification.

If prior approvals/concurrence have not been obtained by the FPI, the investment beyond the prescribed limit shall be compulsorily divested within the prescribed time.

3. Reporting requirements

- The entire investment details shall be reported within the timelines as specified under Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 in the following manner:

Reporting by	Criteria	Form
Indian company	Investment beyond limit is resulting from fresh issue of Eq. Instruments	Form FC-GPR
FPI	Investment beyond limit is due to acquisition of equity instruments in secondary market	Form FC-TRS
AD Bank	Report amount of reclassified FPI as divestment	LEC (FII) reporting

4. Transfer of equity instruments

- The FPI shall request its Custodian for transferring the equity instruments of the Indian company from its demat account maintained for holding FPI to its demat account maintained for holding FDI.

  After ensuring that the reporting for reclassification is complete in all aspects, the Custodian shall unfreeze the equity instruments and process the request.

5. Additional notes

- These directions will become operative with immediate effect.
- The entire investment of the FPI in the Indian company shall be considered as FDI and shall continue to be treated as FDI even if subsequently, the investment falls to a level below ten percent.
- The facility of reclassification shall not be permitted in any sector prohibited for FDI.
- This RBI's move aligns with a similar update from the SEBI, providing guidelines for FPI to FDI reclassification.

JMP Insights *– This regulatory framework aims to enhance clarity and transparency for foreign investors in the Indian market.*

DID YOU KNOW?

CBDT has launched a Compliance-Cum-Awareness Campaign for FY 2023-24 vide Press Release dated 16 November 2024 to encourage resident taxpayers to report their Foreign Assets (‘FA’) and Foreign Source Income (‘FSI’) accurately in their Income Tax Returns (‘ITR’).

Taxpayers who possess such FA and FSI but have filed either ITR-1 or ITR-4 should file a revised return for FY 2023-24 declaring such FA and FSI by **31 December 2024.**

Failure to disclose FA and FSI can attract stringent penalties and prosecution under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BMA).

Should you wish to discuss any of the above issues in detail or understand the applicability to your specific situation, please feel free to reach out to us on coe@jmpadvisors.in.

We would like to take this opportunity to announce that JMP Advisors has recently been awarded **'Top 10 Most Promising Transaction Advisory Firms in India 2025 – Finance Outlook India'** for its outstanding services. We are proud to receive this accolade and endeavour to continue providing high quality services to our clients!

JMP Advisors Private Limited

12, Jolly Maker Chambers II, Nariman Point, Mumbai 400 021, India

T: +91 22 22041666, E: info@jmpadvisors.in, W: www.jmpadvisors.com

About JMP Advisors

JMP Advisors is a leading professional services firm that offers advisory, tax and regulatory services. The vision of JMP Advisors is to be 'The Most Admired Professional Services Firm in India'. It aims to be the best as measured by the quality of its people and service to clients. The firm has a merit-based culture and operates to the highest standards of professionalism, ethics, and integrity. Jairaj (Jai) Purandare, the Founder Chairman has over four decades of experience in tax and business advisory matters and is an authority on tax and regulation in India. Jai was Regional Managing Partner, Chairman-Tax and Country Leader-Markets & Industries of PricewaterhouseCoopers India. Earlier, Jai was Chairman of Ernst & Young India and Country Head of the Tax & Business Advisory practice of Andersen India.

JMP Advisors offers advice in international taxation, domestic taxation, transfer pricing, mergers and acquisitions, Goods and Services Tax (GST), business laws and exchange control regulations and foreign investment consulting. We specialize in fiscal strategy and policy foresight and are also trusted advisors to high net worth families. Our team at JMP Advisors takes pride in being the best at what matters most to clients-technical expertise, innovative solutions, consistent, high quality service, reliability, and ease of doing business.

JMP Advisors has been consistently recognized as a leading Tax firm in India, *inter alia,* in the International Tax Review (Euromoney) World Tax Directory for all successive years since incorporation, including the 2024 Directory.

Disclaimer

This material and the information contained herein is of a general nature and is not intended to address specific issues of any person. Any person acting on the basis of this material or information shall do so solely at his own risk. JMP Advisors Private Limited shall not be liable for any loss whatsoever sustained by any person who relies on this material or information.

© JMP Advisors Pvt Ltd 2024