

Tax considerations due to Covid 19

Bhaumik Goda

18 April 2020

BGSS & Associates

Navigating challenge

- Revisit business projection and ground realities for the purpose of opting for concessional tax rate under section 115BAB
- Unlock cash in litigation
 - Aggressively pursue ongoing litigation
 - Pending rectification under section 154 and order giving effect to appellate order
- Obtain lower withholding certificate to reduce cash blockage
- Reconsider Vivad Se Vishwas scheme decision matrix. Possible to get refund if tax is paid
- Evaluate possible tax efficiency within supply chain and closely consider downside of aggressive claims
- Business restructuring to consolidate business and bring synergy to books

Deductibility of Covid 19 expenditure

Explanation 2 to section 37

For the removal of doubts, it is hereby declared that for the purpose of sub-section (1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the assessee for the purpose of the business or profession

CSR covers C19 expenditure

- Spending on Covid 19 and contribution to PM CARES Fund is eligible for CSR activities [Circular 10 of 2020]
- FAQs issued, contribution to CM funds not CSR, ex-gratia payment is made to temporary /casual workers/ daily wage workers over and above the disbursement of wages is CSR

Issues

- Deductibility of expenditure to taxpayers to whom CSR provisions does not apply
- Deductibility of C19 expenditure which Company proposes not to claim as CSR for Cos Act 2013 compliance

Deductibility of Covid 19 expenditure

Situation 1: Assessee is not required to comply with CSR norms

- Section 37(1) permits deduction if expenditure is incurred 'for the purpose of business'
- Assessee will have to establish nexus between C19 expenditure and assessee business
- Courts have held factors like meeting social obligation, impact on goodwill on contribution to society etc as factors meeting test of commercial expediency and deduction has been granted
 - CIT v. Madras Refineries Ltd., (2004) 266 ITR 170 (Mad)
 - Orissa Forest Development Corporation Ltd. v. JCIT, (2002) 80 ITD 300 (Cuttack)
 - Surat Electricity Co. Ltd. v. ACIT, (2010) 5 ITR(Trib) 280 (Ahd)
- Explanation 2 to CSR is applicability only to assessee who incurs CSR referred to in section 135. If expenditure is incurred voluntarily it does not fall within the purview of Exp 2 to section 37(1) [PCIT v. Gujarat Narmada Valley Fertilizer and Chemicals Ltd (2019(8) TMI 1288-Gujarat HC)]

Deductibility of Covid 19 expenditure

Situation 1: Assessee is not required to comply with CSR norms

- Deduction under section 37(1) can be claimed in addition to deduction under section 80G
 - Mysore Kirloskar Ltd. v. CIT (1987) 166 ITR 836 (Karn)
 - Jaswant Trading Co. v. CIT (1995) 212 ITR 24 (Raj)

Deductibility of Covid 19 expenditure

Situation 2: Deductibility of C19 expenditure not claimed as CSR

Expenditure is deductible

- Exp 2 to sec 37(1) states expenditure on activities relating to CSR referred in section 135
- Thus, what Company accounts for CSR should only be accounted
- Limitation is by way of Exp 2 to section 37(1) and not placed under section 40 which completely debars deduction

Expenditure is not deductible

- Exp 2 to sec 37(1) states CSR “referred to” in section 135. Referred means as mentioned
- Memorandum introducing provision regards such expenditure as application of income
- Section 135 puts 2% as minimum expenditure. Company is free to spend more

Government fiscal initiatives

Taxation and other Laws (Relaxation of Certain Provisions) Ordinance, 2020

- The date for making various investment/payment for claiming deduction under Chapter-VIA-B of IT Act which includes Section 80C (LIC, PPF, NSC etc.), 80D (Mediclaim), 80G (Donations), etc. has been extended to 30th June, 2020. Hence the investment/payment can be made up to 30.06.2020 for claiming the deduction under these sections for FY 2019-20
 - PM CARES Fund shall be eligible for 100% deduction under section 80G of the IT Act.
 - Further, the limit on deduction of 10% of gross income shall also not be applicable for donation made to PM CARES Fund.
- Possible that tax paid for FY 2019-20 may be refunded with interest
 - Can assessee claim section 80G deduction on contribution to PM CARES after 1 April 2020 as deduction for FY 2020-21 (e.g. losses in FY 2019-20, dividend getting taxable in hands of shareholder etc)

Impact on salaried employees

- Lockdown and economic downturn may result in salary pay-cut or deferment of salary accordingly consideration will have to be given by employer on TDS obligation and employee on its tax liability
 - Situation 1: Pay-cut agreed between employee and employer
 - Situation 2 : Deferment of part salary payment on account of cash crunch but no pay-cut
 - Situation 3 : Deferment of part salary payment as also uncertainty on salary commitment
- Employer have to deduct tax on estimated salary for entire financial year [Yearly salary circular issued by CBDT]
- Evaluation of ESOP to retain talent
- Consider pre-posing of vesting date of existing ESOP plan considering downward valuation

Rental income

Taxation of let out property

- Sum for which property might be reasonably be expected to let from year to year [Sec 23(1)(a)]
- Actual rent received or receivable if it is more than deem ALV above [Sec 23(1)(b)]
- When actual rent received or receivable is less than deem ALV on account of vacancy then, actual rent received or receivable [Sec 23(1)(c)]
- Unrealised rent should not be included only if Rule 4 is complied with

Issues on account of C19

- Tenant invokes force majeure clause
 - Acceptable by lessor and no rent is payable
 - Not acceptable by lessor and parties are in legal dispute
- Tenant request for rent deferral
- Tenant refuses to pay rent and vacates premises
- Lessor could not let out property on account of lock down and subsequent market scenario

Rental income

- Vacancy allowance can be claimed if property could not be let out and accordingly ALV will be Nil
 - Sachin R. Tendulkar v DCIT [2018] 96 taxmann.com 253 (Mumbai - Trib.) - could not find a suitable tenant despite making efforts
 - Empire Capital (P.) Ltd v DCIT [2018] 96 taxmann.com 253 (Mumbai - Trib.) - obstruction caused by ongoing Metro Project just before entrance of premises
 - Ms. Priyananki Singh Sood v ACIT [2019] 101 taxmann.com 45 (Delhi - Trib.) - Property could not be let out due to falling prices

See Contra Ruling: Susham Singla [2016] 76 taxmann.com 349 (Punjab & Haryana) SLP dismissed by SC

Essential to document bonafides on efforts taken to rent property

Rental income

Section 23(5) provides that property consisting any building or land appurtenant held as stock in trade and the property or part is not let during whole or any part of previous year, the annual value of property for period upto one from end of financial year in which certificate of completion of construction is obtained shall be Nil

- Taxation only after 1 year from end of financial year in which OC is obtained
- No taxation for unsold inventory if OC is not obtained even if possession is given to other tenant
- Can vacancy benefit under section 23(1)(c) be claimed on the ground of inability to find lessee at mutually agreeable term?

Revenue recognition

- Sale of goods [ICDS IV]
 - Evaluate whether significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control
 - Evaluate reasonable certainty of its ultimate collection
- Construction contract and service [Sec 43CB]
 - POCM basis in accordance with ICDS
 - PCM method if duration of service is not more than 90 days
- Estimation of POCM is likely to be complex exercise on account of entity specific and industry specific contingency. Estimation made while offering advance tax and reality at year end needs to be reconciled. Advance tax working to factor POCM for FY 20-21
- Income which is unlikely to accrue (say force majeure clause) need not be offered to tax [Shopping Mall and Business Park offering income under PGBP]

Revenue recognition

- Interest Income

- ICDS IV requires interest to be accounted on time proportionate basis
- Possible to stop interest accrual if ultimate recoverability is lacking
 - CIT v Vasisth Chay Vyapar Ltd. [2011] 330 ITR 440 (Del)
 - DIT v Credit Suisse First Boston (Cyprus) Ltd. [2013] 351 ITR 323 (Bom)

- Contra : Circular No 10/2017

Question 13: The condition of reasonable certainty of ultimate collection is not laid down for taxation of interest, royalty and dividend. Whether the taxpayer is obliged to account for such income even when the collection thereof is uncertain?

Answer: As a principle, interest accrues on time basis and royalty accrues on the basis of contractual terms. Subsequent non recovery in either cases can be claimed as deduction in view of amendment to Section 36 (1) (vii). Further, the provision of the Act (e.g. Section 43D) shall prevail over the provisions of ICDS

Business Income

- Provision for expected loss in case of onerous contract & liquidated damages
 - ICDS 1 states that expected loss shall not be recognised unless same is in accordance with other ICDS
 - Section 36(1)(xviii) provides M2M loss or other expected loss shall be computed in accordance with ICDS
 - Section 40A(13) provides no deduction or allowance shall be allowed in respect of any M2M loss or expected loss except allowable under Section 36(1)(xviii)
 - ICDS X provides no provision shall be recognised for costs that need to be incurred to operate in the future
- Aforesaid provisions may be deductible under MAT as they are not 'unascertained liability'.

Business Income

- Liquidated damages, enforcement of bank guarantee is otherwise tax deductible as business expenditure
 - PCIT v Green Delhi BQS Ltd [2019] 417 ITR 162 (Delhi)
 - CIT v Rambal (P.) Ltd [2018] 96 taxmann.com 170 (Madras)
 - PCIT v Mazda Ltd [2017] 250 Taxman 510 (Gujarat)
 - Haji Aziz and Abdul Shakoor Bros [1961] 41 ITR 350 (SC)
- Deductibility of forex losses in accordance with ICDS V
- Remeasurement of expenses
 - ESOP expenses – assumption may change resulting in reversals
 - Warranty provision – possibility of extension of warranty period on account of lock down and Company inability to reach customer
 - ICDS X prohibits discounting to present value (NPV) and accordingly back up papers of past claim should be reconciled with revised estimate ignoring NPV

Business Income

- Impact on fixed asset and depreciation
 - Delay in user test on account of lock down, travel restriction, supply chain disruption resulting in change of depreciation charge
 - Increase in forex hit and consequent change in WDV on loan repayment pursuant to section 43A
 - ICDS IX mandates capitalisation of general borrowing cost if qualifying asset takes more than 12 months for its acquisition or construction. Unlike AS 16 or Ind AS 23 ICDS does not provide for suspension of borrowing cost for period where active development is suspended. This may require close reconciliation for tax computation
- Deduction for write off of bad debt and advance to suppliers in case of default
- Increased provision for bad debt on account of Expected Credit Loss method to measure provision

Business Income

- Perishable and seasonal product may have to be valued at Net Realisable value on 31 March 2020 in accordance with ICDS 2
 - Item by item comparison is required – possible to have different closing stock value for export & domestic market depending upon C19 exposure
 - NRV may be NIL for goods like BS VI vehicles, perishable goods, goods with short shelf life stuck in transit
- Impact on going concern for entities significantly hit by shut down, supply chain constrain, inability to find financial resource, loss of major customer/supplier, loss of market
 - Going concern is fundamental assumption in ICDS 1 and tax auditor will have to comment upon its compliance
 - Section 176 mandates assessee to inform AO about discontinuance
 - Distinguish between lull in business v/s closure of business

Debt Restructuring

Renegotiation of loan

Ind AS accounting

- Ind AS 109 requires an entity to determine whether the present value of new cash flows under new terms is at least 10% different from the present value of the remaining cash flows of the original liability, using the original effective interest rate
- If the difference is 10% or more, the existing liability is derecognised and a new financial liability is recognised at fair value.

Taxability

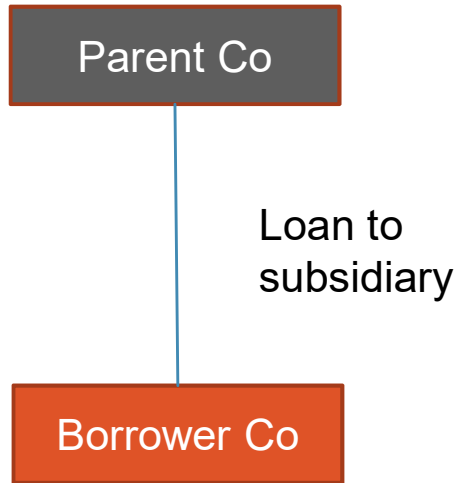
- Assume loan of Rs 100 crs bearing interest at 12% payable after 3 years is restructured as
 - a) Rs 50 crs as RPS with 12% dividend rate payable after 10 years
 - b) Balance loan on same terms payable after 5 years with 5% interest
- Journal entry for renegotiation of loan

Loan (old loan)	100	
	To New Loan (NPV value)	38
	To RPS (NPV Value)	22
	To Gain in P&L	40

Renegotiation of loan

- MAT is not payable if amount is not income under Income Tax Act
 - PCIT v Ankit Metal & Power Ltd [2019] 416 ITR 591 (Calcutta)
 - ACIT v JSW Steel Ltd 2020] 180 ITD 505 (Mumbai - Trib.)
 - Sipca India (P.) Ltd. v. Dy. CIT [2017] 80 taxmann.com 87 (Trib.)
 - ACIT v. Shree Cement Ltd. [IT Appeal Nos.614, 615 & 635 (JP) of 2010) Shree Cement Ltd, v. Addl. CIT [2015] 152 ITD 561/[2014] 49 taxmann.com 274 (Jai. - Trib.)
 - CIT v. Veekaylal Investment Co. (P) Ltd. [2001] 249 ITR 597/116 Taxman 104 (Bom)

Write off of loan to subsidiary

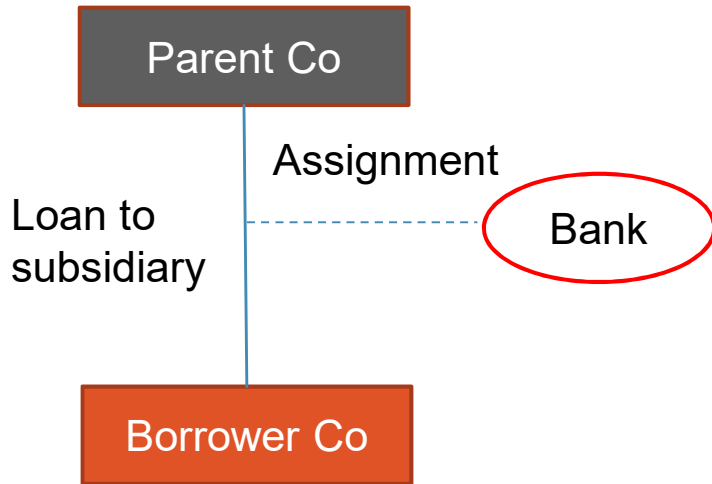


- Parent Co advanced loan to subsidiary
- Subsidiary is not in position to pay loan and accordingly such loan is written off

- Favourable
 - DCIT v M/s Industrial Development Bhubaneswar Corporation of Orissa Ltd [ITA No.379/CTK/2017]
- Unfavourable
 - Salem Magnesite (P.) Ltd. [2009] 180 Taxman 545 (Bombay)
 - JCIT v Rallis India Ltd [2010] 3 ITR(TRIB.) 1 (MUM.)
 - Crompton Greaves Ltd v DCIT [2014] 50 taxmann.com 88 (Bombay)

Essential to establish business nexus and coherence of business

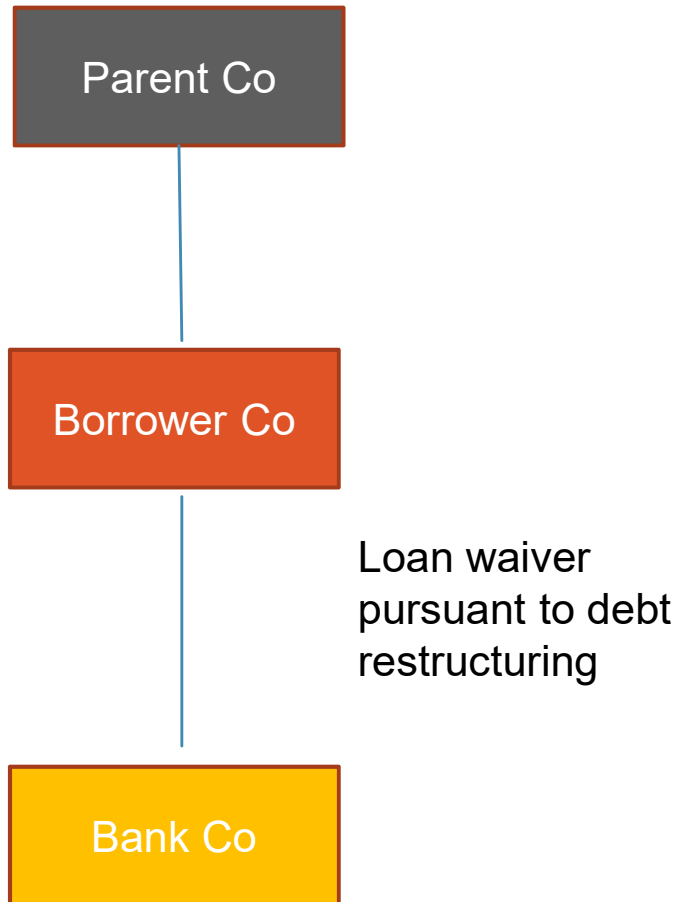
Write off of loan to subsidiary



- Favourable
 - CIT v.Minor Babebhai Alias Lav Kumar Kantilal [1981] 128 ITR 1 (Guj)
 - CIT v Siemens Nixdorf Information Systemse GmbH [2020] 114 taxmann.com 531 (Bombay)
 - PCIT v Reliance Natural Resource Ltd [2019] 111 taxmann.com 413 (Bombay)

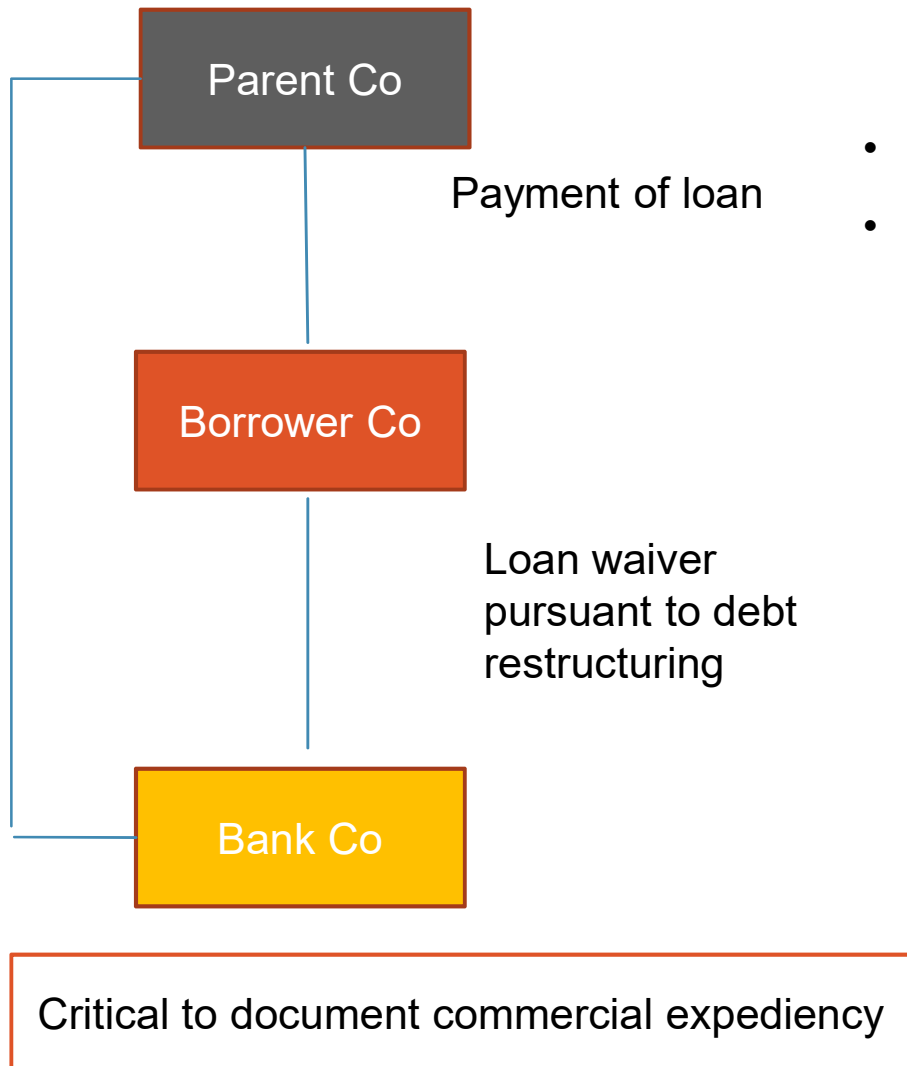
- Parent Co advanced loan to subsidiary
- Parent Co assigns loan to third party and claims loss under CG

Loan Waiver



- Bank Co enters into debt restructuring and waives off 40% of debt and 80% of outstanding interest and reconstructs the account
- Normal Tax
 - Waiver of principal component not taxable under section 41(1) [CIT v. Mahindra & Mahindra Ltd [404 ITR 1]
 - Ratio may be applicable to waiver of working capital loan as well [See CIT v Compaq Electric Ltd [2019] 101 taxmann.com 400 (SC)]
- MAT
 - Debatable considering reliance on [JSW Steel Limited [TS-76-ITAT-2017(Mum)]

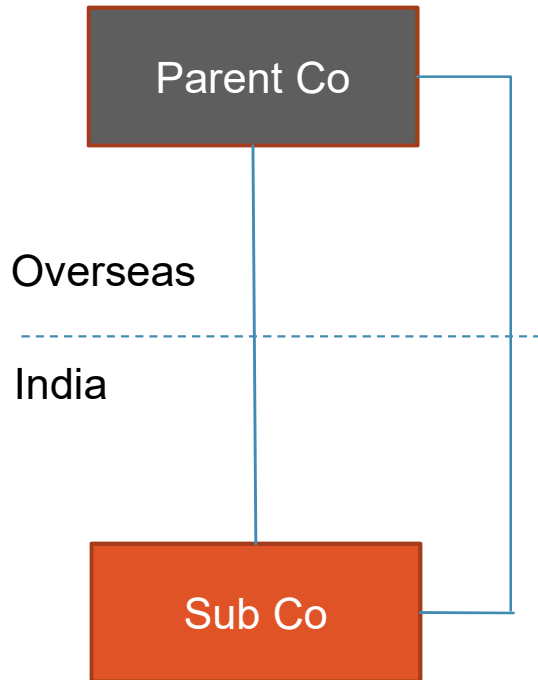
Parent Co pays as guarantor



- Parent Co has given guarantee for loan repayment. Parent Co pays loan pursuant to guarantee
- Can Parent Co claim deduction of loan repayment?
- Favourable
 - J. K. Synthetics Ltd [2014] 369 ITR 310 (Allahabad)
 - CIT v Rudra Industrial Commercial Corporation [2012] 20 taxmann.com 611 (Karnataka)
 - Spencers and Co. Ltd. [2014] 47 taxmann.com 55 (Madras)
- Negative
 - LML Ltd [2014] 46 taxmann.com 377 (Mumbai - Trib.)
 - Brij Mohan Laxmi Narain [1959] 36 ITR 147

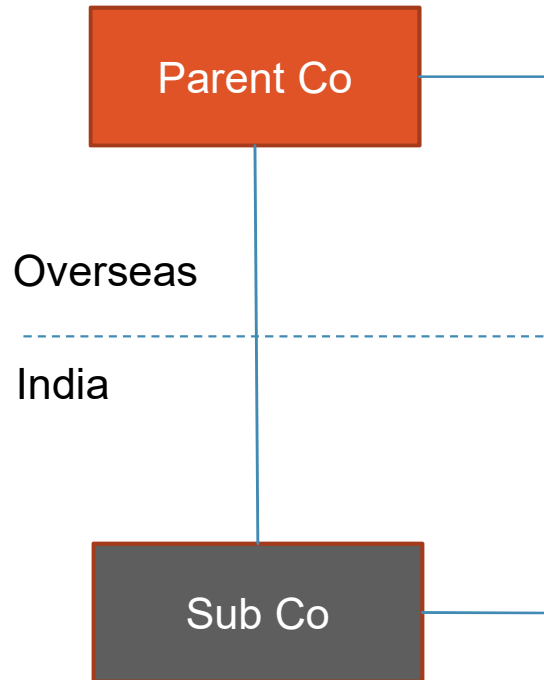
Inter company funding

Funding Sub Co



- **Option 1 : Equity Shares**
 - Easier with no downside
 - Money Blocked
- **Option 2: ECB**
 - End use restriction
 - 5% withholding rate
 - Temporary funding
 - End use restriction
 - Section 94B
- **Option 3: NCD**
 - No end use restriction
 - Listing/unlisted NCD to be issued in accordance with FEMA
 - No end use restriction

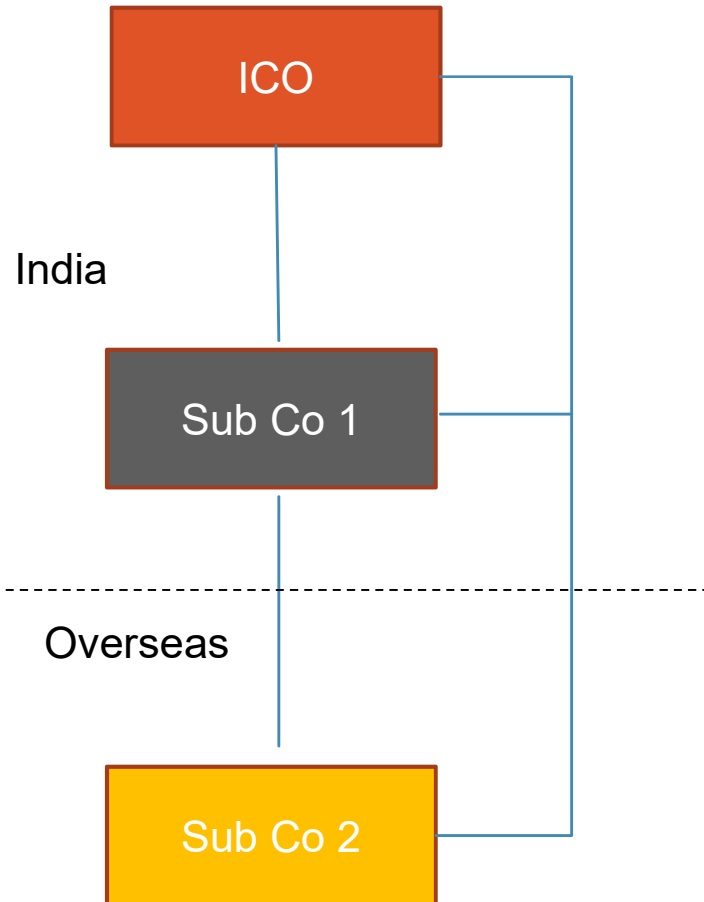
Repatriation outside India



- **Option 1: Dividend distribution**

- Dividend taxable in hands of Parent Co
- Treaty rate:
 - India – Mauritius – 5%
 - India – Singapore – 10%
- Evaluate applicability of MFN clause for treaties with Netherland, France, Sweden, Switzerland, Hungary etc as India has agreed a lower rate of 5% with Slovenia and Lithuania
- Safeguard : GAAR, PPT, Beneficial Ownership, TRC, Form 10F etc

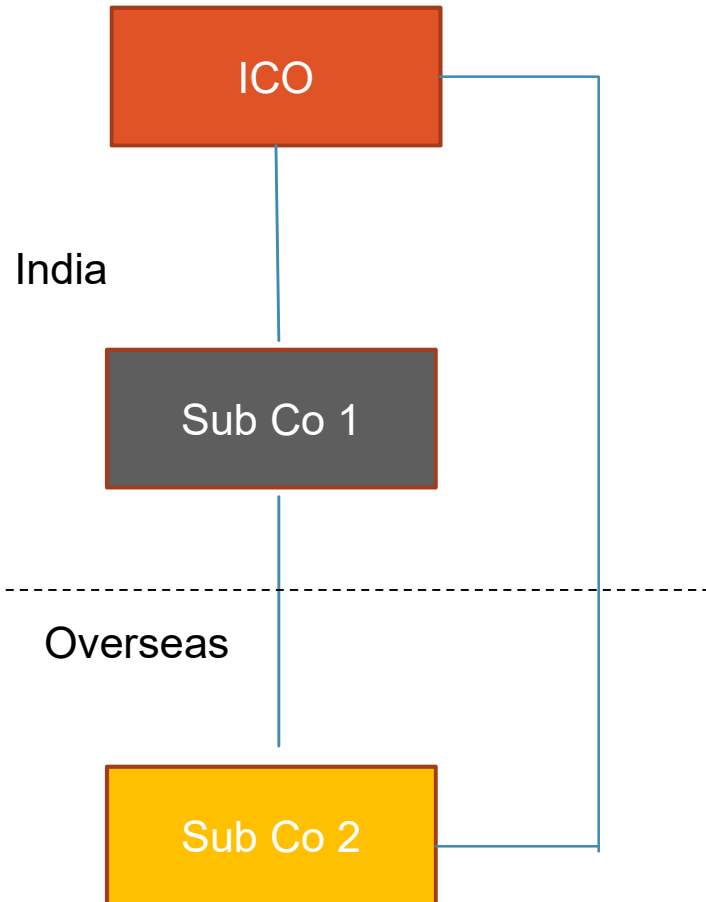
Funds within group company



Option 2: Benefit of section 80M

- Sub Co 2 declares dividend to Sub Co 1
- Sub Co 1 pays tax under section 115BBD
 - No tax payable if treaty with overseas jurisdiction have underlying tax credit
- Sub Co 1 rolls over dividend to ICO and avails benefit under section 80M thereby not paying tax on dividend
 - MAT tax payable unless opted for section 115BAB
- ICO receives dividend. However if ICO has business loss then dividend income can be set off against ICO business loss.
 - MAT tax payable unless opted for section 115BAB

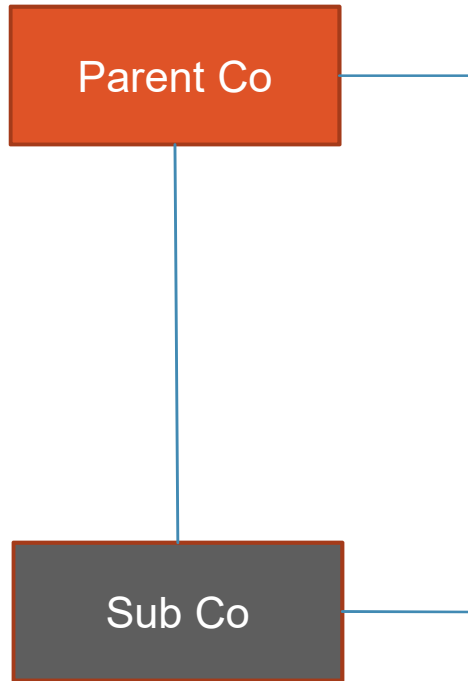
Funds within group company



Option 3 : Merger/demerger of overseas Co

- Inbound merger/demerger of Sub Co 2 with ICO permissible under Cos Act 2013
- Transaction is not taxable for either parties
- May avoid risk of Sub Co 2 POEM as also TP attribution pursuant to CBcR if so perceived by management
- Transaction to be supported by sound commercial rationale

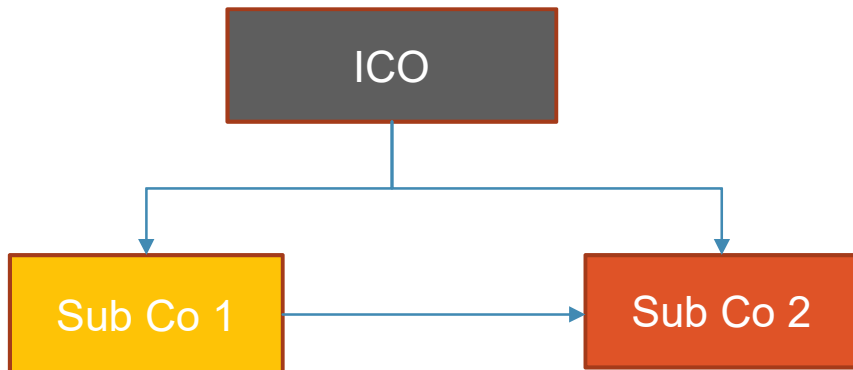
Repatriation outside India



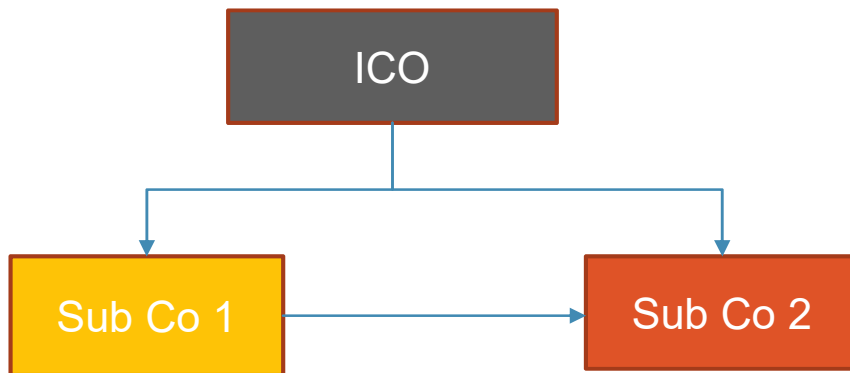
- **Option 4: Buyback of shares**

- Sub Co may buy back its own shares in accordance with Sec 68 of Cos Act 2013
- Taxable at 115QA at 23.3% on distributed income
- Consideration exempt in hands of shareholder under section 10(34A)
- Limitations
 - Section 14A implication in hands of Parent Co
 - Overall quantum of buy back amount is restricted by section 68

Funds within group company



Subscription to RPS



Intercorporate Deposit

Option 1 : Subscription to RPS

- Arguably RPS should not attract section 79 and accordingly brought forward loss protected
- RPS is not loan and accordingly does not attract deem dividend [Jasubhai Engineering Pvt. Ltd [TS-167-ITAT-2020(Mum)]]

Option 2: Intercorporate Deposit

- ICD is not loan and accordingly does not attract deem dividend [KIIC Investment Company; Contra : Dhariya Construction Pvt. Ltd [TS-86-ITAT-2020(PUN)]]

Shares & Securities

Shares & Securities

- Possibility of portfolio realignment by booking losses to cover against future gains in respect shares purchased
- Section 56(2)(x) and section 50CA implication in case of stress buy-out
 - ACIT v Subhodh Menon [2019] 103 taxmann.com 15 (Mumbai)
 - K P Varghese v ITO [1981] 131 ITR 597 (SC)
- Impact on past and present transaction on account uncertainty in future business
 - Issuance on shares pre-Covid 19 basis of DCF valuation by Mercant Banker.
 - Essential to document change in actual numbers on account of Covid 19 to justify valuation at the time of issuance of shares
 - Uncertainty in valuation assumption to value fresh issue after Covid 19
 - Valuation of intangible for the purpose of TP

International Taxation

Residential Status

- Change in residential rule for Indian citizen or PIO having Indian source income in excess of Rs 15 L
 - Presence < 120 days – NR
 - Presence > 120 but < 182 days – NOR
 - Presence > 182 days – RNOR
- Can stay in India on account of lockdown be ignored for consideration of residential status
 - CIT v Suresh Nanda (2015) 57 Taxman.com 448

Permanent Establishment

- NR may have taxable presence in India if their stay exceeds specified duration under tax treaty (e.g. Construction PE, Service PE etc)
- Whether law requires consideration of active days or arithmetic calculation of physical presence
- OECD Guidelines

“Working from home during the COVID-19 outbreak normally results from governmental directives rather than from a requirement from an enterprise. Working from home during the COVID-19 crisis does not have a sufficient degree of permanency, the worker has an office in normal circumstances, and the enterprise has no access or control over the home office. In order to qualify for a PE, an individual’s activities must contain a certain degree of permanency and must not be temporary or transitory. Under the assumption that remote work is a temporary circumstance and it does not become a permanent arrangement over time, working from home during the pandemic should not create a PE for the company”

Transfer Pricing

- TP policy for intra group transaction for FY 2020-21 considering change in mark up on account of change in economic conditions
- Continuity of safe harbour provisions opted in earlier years
- Possibility of moratorium in case of loan given to AEs in high Covid19 impacted regions
- Business restructuring implication in case of change in business model
- Comparability challenge
 - Average of 3 years data for benchmarking
 - Impact of Covid 19 on comparable companies
- Evaluate impact on concluded APAs

Thank You

MUMBAI

605, Zee Nayak, M.G. Road, Vile Parle (East),
Mumbai – 400 057

Email : bhaumik@bgss.co.in

Mobile No: +91 98339 15583

AHMEDABAD

604, Shitiratna Building, Panchwati Circle, C.G.
Road, Ahmedabad – 380 009

Email : saumya@bgss.co.in

Mobile No: +91 90999 27783

