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TAX FLASH NEWS

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Mere technical error in the return of income would not defeat the claim of tax treaty benefit

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Pramerica ASPF II Cyprus Holding Limited[1] (the taxpayer) held that mere technical error in the income-tax return filed would not defeat the claim of the taxpayer for entitlement to tax treaty benefits. Non-filing of Schedule-SI in the form of the return of income is an inadvertent omission, and it is required to be accepted by the tax department. Therefore, the taxpayer is entitled to claim the tax treaty benefits, and its income is liable to be taxed at the lower rate of 10 per cent.

The Tribunal also held that there is an inadvertent error of the taxpayer in considering interest income on accrual basis. The interest income is liable to be taxed on payment/receipt basis since Article 11(1) of the India-Cyprus tax treaty (tax treaty) provides for taxation of interest income on payment/receipt basis and not on an accrual basis.

Facts of the case

- The taxpayer is a tax resident of Cyprus. It is engaged in the business of making an investment in real estate development companies in India.
- During the Assessment Year (AY) 2010-11, the taxpayer filed a return of income declaring interest income earned from Compulsory Convertible Debentures (CCDs) of the investee companies in India engaged in the business of development of real estate. The said income was offered to tax at 10 per cent as per the provisions of Article 11(2) of the tax treaty. Further, the interest income earned from CCDs was declared by the taxpayer for taxation on receipt basis.
- The Assessing Officer (AO) held that the interest income is taxable on an accrual basis and not on receipt basis. The AO held that the income is taxable at the normal rate of 43.23 per cent on the ground that the taxpayer did not fill up the 'Special Income' (SI) schedule in the return of income filed. Accordingly, the AO did not allow the benefit of the lower rate of tax prescribed in the tax treaty.

Tribunal ruling

Applicability of beneficial rate of tax under the tax treaty

- The taxpayer is a tax resident of Cyprus, and it is supported by the Tax Residency Certificate (TRC) issued by the competent authority of Cyprus. Therefore, it is eligible to claim the benefit of the tax treaty.

[1] Pramerica ASPF II Cyprus Holding Limited v. DCIT (ITA No. 1113/MUM/2015) – Taxsutra.com

- Non-filing of the Schedule-SI in the form of the return of income is an inadvertent omission, and it is required to be accepted. The lower authorities have been wrong in refusing taxpayer's claim for being taxed at the concessional rate of 10 per cent prescribed in the tax treaty.
- In the Assessment Year (AY) 2009-10, as well as in the computation of income, furnished by the taxpayer, before the AO, reflects that such an omission was an inadvertent mistake.
- The statement of total income including the computation of tax on income, as furnished by the taxpayer, also contained a note stating that the taxpayer is entitled to a beneficial rate of 10 per cent under the tax treaty. Further, the tax liability on the total income has also been computed at 10 per cent. Accordingly, the insistence of the tax department on the filing of the revised return of income to claim a lower rate of tax reflects an over-technical approach.
- The mere technical error would not defeat the claim of the taxpayer, which is otherwise in accordance with law. It is apparent that taxpayer is entitled to the tax treaty benefits, and its income is liable to be taxed at the lower rate of 10 per cent.
- The Rajasthan High Court in the case of Rajasthan Fasteners (P) Ltd.[2] has granted an exemption to the taxpayer under Section 10B of the Income-tax Act, 1961 (the Act) and held that a mere typographical error in mentioning Section 80-IB of the Act in the return of income would not disentitle the taxpayer's claim for exemption under Section 10B of the Act.
- Accordingly, it has been held that the taxpayer is eligible for a confessional rate of tax at 10 per cent under the tax treaty.

[2] CIT v. Rajasthan Fasteners (P) Ltd. [2014] taxmann.com 175 (Raj)

Interest income - accrual basis v. payment basis

- The Bombay High Court in the case of Siemens Aktiengesellschaft[3] having regard to the India-Germany tax treaty held that the assessment of royalty or fee for technical services was held to be taxable on receipt basis.
- Further, in the case of National Organic Chemical Industries Ltd.[4] the Tribunal held that since the payment was covered by the scope of Article 12(4) of the India-Switzerland tax treaty, it was liable to be taxed on the basis of payment. Similarly, in the case of Johnson & Johnson[5] in the context of the India-USA tax treaty, it was held that the expression 'paid' used in Article 12(1) was interpreted to mean that the royalty was to be taxed on 'paid' basis and not on an accrual basis.
- The aforesaid precedents support the understanding of the expression 'paid' used in Article 11(1) of the India-Cyprus tax treaty to mean that the interest income is liable to be taxed on payment/receipt basis and not on an accrual basis.
- The tax department contended that the taxpayer itself is inconsistent in offering to tax such interest income on accrual basis in the return of income filed. However, the taxpayer claimed that there is an inadvertent error in including interest income on accrual basis. In turn, the tax department contended that such solitary error cannot be construed to mean that the taxpayer has not been following the cash basis of accounting regularly. The Tribunal observed that the plea of the taxpayer is justified, and the applicable legal position has to be arrived at by keeping in mind the relevant provisions of law and not merely by the conduct of the parties.

[3] DIT v. Siemens Aktiengesellschaft (ITA No.124 of 2010) (Bom)
[4] National Organic Chemical Industries Ltd. v. DCIT [2006] 5 SOT 317(Mum)
[5] Johnson & Johnson v. ADIT [2013] 32 taxmann.com 123(Del)

- Apparently, Article 11(1) of the tax treaty, which covers the present case provides for taxation of interest income on payment/receipt basis and not on an accrual basis. Therefore, the interest income returned by the taxpayer on a cash basis is to be accepted.

Our comments

In the instant case, the Mumbai Tribunal held that mere technical error in the income-tax return would not defeat the claim of the taxpayer for entitlement to tax treaty benefits. Therefore, the taxpayer is entitled to claim the tax treaty benefits, and its income is liable to be taxed at a beneficial rate. The Tribunal also held that the interest income is liable to be taxed on receipt basis since Article 11(1) of the tax treaty provides for taxation of interest income on payment/receipt basis and not on an accrual basis.

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