Direct Tax Vista

Your weekly Direct Tax recap

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Friends

We are pleased to put forth this issue of DTV in three Sections as under -

Section I - Coverage and Updates on Income Tax Act Revamp (Comprehensive Review) from 1st February 2025 as announced by the Union Finance Minister in The Budget (No.2) in 2024.

Section II - Video on Weekly Developments under Income Tax, International Taxation & International Trade

Section III - Coverage of most critical issues in Income Tax, International Taxation & International Trade in the bygone week.

We hope that this revamped DTV would assist you in your professional spheres.

Section I - Coverage and Updates on Income Tax Act Revamp (Comprehensive Review) from 1st February 2025 as announced by the Union Finance Minister in The Budget (No.2) in 2024.

Merging Provisions, Explanations & Illustrations in the Act; Inculcate provisions for increasing accountability of officers & Introducing Ease of Compliance

A. Building in Provisions & Explanations in the Act and inculcating Illustrations –

Today each Section and Rule of The Income Tax Act is flooded with Provisions and explanations. Then there are circulars as well as notifications, some of which are so old that it is even difficult to find them publicly. This makes reading the Income Tax Act complex.

Even incase one reads the Act and Rules successfully, due to multiplicity of Provisions, explanations, circulars and notifications, interpretation gets into litigation.

It is recommended that all Provisions, explanations, circulars and notifications related to a Section or Rule be merged with the Section or Rule.

Further, Illustrations may be added in the Section or Rule itself so that litigation due to interpretation can be reduced

B. Inculcate provisions for increasing accountability of officers

Increased Accountability of Tax Officials for passing orders in time - Implement accountability measures for tax officers for passing orders in time, ie rectification orders / appeal effect orders and appeal orders. For Example - Sec 154(8) stipulates that the IT Authority shall pass an order (either by rectifying the original order or denying the said application) within 6 months of application filed. However, it is seen that in ground reality the JAO is not passing the order within the stipulated timeline and the assessee has to file multiple applications.

Holding officers accountable will improve tax administration efficiency and close litigation in a time bound manner. This maybe built into the Act itself as it will inculcate more confidence in the citizens also to make Income Tax Dept. more efficient. For Eg. Suitable provision may be introduced so that JAO is bound to dispose off the rectification petition within the prescribed timeline. If the JAO does not do so, application u/s 154 would be deemed to be allowed and the JAO should be bound to rectify the mistake.

C. Introducing Ease of Compliance

The revamping should be designed in a way that makes compliance way more simpler for both individuals and businesses operating in India.

1. Common Income Tax Return (ITR) Form – Many disputes happen due to multiple ITR Forms and taxpayers make a mistake in filing the correct form. A case in point is the fact that many taxpayers who have Foreign Assets have filed ITR-1 or ITR-4 whereas they should have filed ITR-2 or ITR-3. Hence they have skipped filing the Foreign Exchange Assets/ Income Schedule. Common ITR Form Would eliminate this confusion. There may be a question that it may make the form big, however it may be divided into various sections and sections not applicable to a taxpayer may not at all be attempted. This would make the filing simpler.

2. With different deadlines for filing income tax returns, TDS return, tax audit, transfer pricing etc, there are chances of missing the dates, leading to penalties. Unification of dates should be done to the best extent possible for all assesses.

Section II - Video on Weekly Developments under Income Tax, International Taxation & International Trade

https://youtu.be/n088LeNQ-1U

Section III - Coverage of most critical issues in Income Tax, International Taxation & International Trade in the bygone week

1. Transaction mismatches for FY 2023-24 and FY 2021-22: File revised/ Belated ITR/ ITR-U

The Income Tax Dept has sent SMS and emails to taxpayers and non-filers where it has identified mismatch between transactions reported in Annual Information Statement (AIS) and income disclosed in ITRs for the financial years 2023-24 and 2021-22. This campaign has also targeted individuals having taxable income or significant high-value transactions reported in their AIS but have not filed ITRs for the respective years.

Taxpayers can file their revised or belated ITRs for FY 2023-24. The last date to file these revised or belated ITRs is December 31, 2024. For cases pertaining to FY 2021-22, taxpayers can file updated ITRs by the limitation date of March 31, 2025.

2. Domestic transfer pricing: Specified Domestic transaction to exclude payments made u/s 40A(2)(b); Inter-unit comparison of net profit in these GST times

Various issues in Domestic transfer pricing have come up recently on which various judgements have been passed –

i. Specified Domestic transaction to exclude payments made u/s 40A(2)(b)

Section 92BA(i) of Income Tax Act was deleted w.e.f. 1.7.2017 and before deletion required that "specified domestic transaction" includes “any expenditure in respect of which payment has been made or is to be made to a person referred to Section 40A(2)(b)”.

The omission of a particular provision in a statue would not save the acts done earlier and therefore the normal effect of repealing a statute or deleting a provision is to obliterate it from the statute book as completely as if it had never been passed, and the statute must be considered as a law that never existed. The issue is no more res-integra in the light of authoritative pronouncement of Hon'ble Apex Court in the matter of **KOHL4PUR CANESUGAR WORKS LTD. v. UNION OF INDIA** reported in AIR 2000 SC 811 where under Apex Court has examined the effect of repeal of a statute visa-vis deletion/addition of a provision in an enactment and its effect thereof.

Thus, when clause (i) of Section 92BA having been omitted by the Finance Act, 2017, with effect from 01.04.2017 from the Statute the resultant effect is that it had never been passed and to be considered as a law never been existed. Therefore, it was held accordingly in the case of **GOLDBRICKS INFRASTRUCTURE PVT LTD Vs ASST. COMMISSIONER OF INCOME TAX [2024-VIL-1794-ITAT-RPR]**

ii. Addition due to difference in profitability of different Units

In the current age of GST where the trial balance is maintained state-wise, can the same be used by Income Tax Authorities for domestic transfer pricing purposes adding expenses of certain units which show a lower net profit? In such matters, it has been held in plethora of judgements that merely low profit by itself is not a valid criterion for not accepting profit shown in books of account. There may be various reasons for it like –

A. Higher depreciation due to newer technologies installed
B. Higher labour, fuel, power, etc expenses

For substantiating such an allegation, the AO has to -

A. Either point out any discrepancy in the books of account
B. Or reject the books of account u/s 145 of the I.T. Act
C. Or has to bring on record a specific instance of under reporting or over reporting of revenue
D. Or has to point out an instance of bogus or excessive claim of any expenses or under reporting of expenditure.

This was upheld in the cases of CIT Vs Poonam Rani 5 Taxmann.com 76 (Del), CIT Vs. Mohd Umer 101 ITR 525 (Patna) and now was again upheld in the case of **A.C.I.T. Vs M/s PRAG INDUSTRIES (INDIA) PVT LTD [2024-VIL-1788-ITAT-LCK]**

3. Additions cannot be made for TDS defaults by merely unearthing a non-deduction or non-payment... It should be seen whether the said recipients were subjected to tax or not

Proviso to Section 201(1) states as follows -

Provided *that any person, including the principal officer of a company, who fails to deduct the whole or any part of the tax in accordance with the*

*provisions of this Chapter on the sum paid to a payee or on the sum credited to the account of a [19]**[**payee**]** shall not be deemed to be an assessee in default in respect of such tax if such [19]**[**payee**]**-*

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income,

and the person furnishes a certificate to this effect from an accountant in such form as may be prescribed:]

Hence, additions cannot be made for TDS defaults by merely unearthing a non-deduction or non-payment. Incase an assessee has made payments to various parties and claimed the expenditure in its books of accounts, with the recipients' names and PAN details available, then it is the responsibility of the Assessing Officer as well as the assessee to verify whether the said recipients of the amounts were subjected to tax or not.

It has to be found out whether the recipient of the claimed expenditure has paid the due taxes or not. The assessee should file all necessary evidence as was held **BHARGAVI MARKETERS Vs THE INCOME TAX OFFICER [2024-VIL-1795-ITAT-HYD]**

4. High Seas Sales are non-speculative transactions

In the context of high seas transactions, the original seller being the exporter transfer possession of a commodity by parting with the commodity at the time of uploading on the vessel to be delivered to the original buyer that at the specified port. Such transfer is the same acknowledged by a document called „Bill of lading'. During the course of transit, the buyer enters into a contract with the subsequent buyers for sale of commodity loaded on the vessel and deliver the same by endorsing the bill of lading in favour of subsequent buyer.

Once a vessel reaches the port, the ultimate subsequent buyer takes physical delivery of the commodity, after payment the customs duty. Thus, in case of high seas transaction there is physical delivery of goods by the original seller to the ultimate buyer, and therefore such transactions does not fall within the sweep of the definition under section 43 (5) of the Income Tax act.

The definition of “documents to the title of goods” as per section 2 (4) of The Sale of Goods Act 1930, that reads as under:

> *“document of title to goods include a bit of leading, talk warrant, warehouse keepers certificate, wharfinger’s certificate was, railway received, warrant order for the delivery of goods and any other documents used in the ordinary course of the business as a proof to the possession or control of goods, or purporting to authorise, either by endorsement or by delivery, the possessor of the document to the transfer received goods thereby represented”*

Section 43(5) of Income Tax Act specifies that *"speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the* ***actual delivery or transfer of the commodity*** *or scrips:*

The Legislature has in specific terms excluded such transaction by using the words “actual delivery, as well as transfer” of commodity.

High Seas Sales have the following features -

A. In a High Seas sale, the assessee buys the goods from one party and sales the goods to other parties.
B. The delivery of goods are taken and given by way of endorsement of bill of lading in favour of the parties to the transaction much before the goods reach its destination.
C. The assessee purchases and sales the goods on the high Seas basis.

D. The assessee gives delivery of goods from the seller by way of endorsement of the documents for purchase consideration and gives the delivery of goods to the buyer for transfer of documents on the sale consideration.

E. The assessee's turnover of sale and purchase are disclosed in the GST returns.

Hence, the transaction of purchase and sale entered when goods are on High Seas by the assessee can never be settled without delivery of goods vis-à-vis a situation that would fall under the mischief of subclause 5 of section 43 of the act.

Under the Income Tax Act, the term 'speculation' focuses on whether the transactions involves actual delivery, transfer, or settlement. Even if the goods or commodities involved are inherently speculative, the crucial factor remains to establish actual delivery. Thus, when delivery of the goods are not taken, the transaction is treated as speculative in nature.

In the decision of Hon'ble Rajasthan High Court in case of Sripal Satyapal vs ITO reported in (2008) 217 CTR 337 and the decision of Hon'ble Andhra Pradesh High Court in case of CIT vs Lakshminarayanan Trading Company reported in (1995) 82 taxman 301 it was held that the case would not fall under the category of speculative transaction. Therefore, following the ratios laid down by the decisions above, it was decided in the case of **EMPIRE MULTITRADE PRIVATE LIMITED Vs DCIT-12(2)(1) [2024-VIL-1783-ITAT-MUM]** that the transaction of purchase and sale undertaken by the assessee when goods are on High Seas, do not amount to being speculative in nature.

5. ESOP Expenses are allowable u/s 37(1) of Income Tax Act

Payments for ESPOs happen in different forms and ESOP expenses should not be regarded contingent or notional and it should be allowed as deduction u/s 37(1) of the IT. Act as was held in the cases of DCIT v Accenture Services P Lid [ITA No. 4540/M/08 order dated 23rd March 2010] and Nordisk India Private Limited v DCIT -12(2) (ITA No. 1275/Bang/2011) (Bang Trib). The same was upheld in the case of

GOLDMAN SACHS (INDIA) SECURITIES PVT LTD Vs THE NATIONAL FACELESS ASSESSMENT CENTRE, DELHI [2024-VIL-1784-ITAT-MUM].

Here the ESOP was issued during year 2006 and provided for option vesting of 40% of the stocks granted and the balance 60% vested after a period of 3 years i.e. in the year 2007 (20%) 2008 (20%) and 2009 (20%). Accordingly the assessee amortized 40% of the cost in the first year of the plan and the balance 60% cost is amortized over the vesting period of three years. As per the accounting policy the grant price on the date of grant of ESOP was amortized in the books of assessee in accordance with vesting schedule as laid down in the plan. The method of accounting was in accordance with the accounting standards in India.

The ITAT followed the orders passed by the coordinate benches and deleted the disallowance made on account of ESOP expenses.

6. One residential Unit Vs Two Residential Units Vs Residential Unit

Certain judgements regarding two important questions have been published which further clarify –

A. Whether ‘a residential Unit’ is a “One residential Unit” or two
B. Whether ‘a residential Unit’ is merely a structure and not a “residential Unit” at all

By virtue of The Finance (No. 2) Act, 2014 [hereafter ‘the Finance Act, 2014’], an amendment had been brought in Section 54F of the Act, whereby the words ‘a residential house’ had been replaced with ‘one residential house’, and thus, the legislature had clarified that the intention was always to allow exemption in respect of one residential house only.

Where an assessee purchases two flats which are situated adjacent to each other or side by side and the flats were purchased with intention of treating as one, it would be treated as ‘one residential unit’. However, in this case, it is an undisputed fact that both the flats purchased by the assessee were on two different storeys

and/or were not adjacent to each other and/or cannot be joined to form one dwelling unit, they would be considered as 'two residential units'. The same was laid down in the case of **MRS. KAMLA AJMERA Vs PR. COMMISSIONER OF INCOME TAX [2024-VIL-241-DEL-DT]**.

Further In the case of **SANDEEP HOODA Vs PR. COMMISSIONER OF INCOME TAX-7, DELHI [2024-VIL-246-DEL-DT]**, the question before the Court was that whether a structure can be considered as a makeshift arrangement or a residential house, Incase the structure consists of plywood rooms with no electricity or water connection, and a vast, uninhabited land, even though in a rural area.

It was held that Plywood rooms without basic amenities such as electricity, water, and proper construction cannot be construed as a residential house under Section 54. A residential house, even in rural areas, must have essential facilities for habitation, such as electricity and water supply. The absence of these amenities rendered the construction inadequate for exemption under Section 54. Certificates provided by the Sarpanch and architect were considered as lacking sufficient evidentiary value to contradict the ground realities.

7. Interest on FD given for Bank Guarantee – Revenue or capital receipt?

For organisations at the pre-commencement stage, the question is whether interest on FD, earned during the pre-commencement of business is liable to tax u/s 56 of the Income Tax Act as revenue receipt or is it a capital receipt? As laid down by Hon'ble Apex Court in the case of Tuticorin Alkali Chemicals and Fertilizers Ltd. Vs. CIT, (1997) 227 ITR 172 (SC) it is liable to tax being revenue receipt. In this case idle or surplus funds were parked in FDs and interest generated thereon.

On the contrary, where money is borrowed by a newly started company which is in the process of constructing and erecting its plant and the interest incurred before the commencement of production on such borrowed money can be capitalized and added to the cost of the fixed assets; Then as a corollary, if the assessee receives any amount which is inextricably linked with the process of setting up of its plant & machinery, such receipts should go to reduce the cost of its assets. The Hon'ble

Supreme Court in the case of CIT VS. Bokaro Steel Ltd. (1999) 236 ITR 315 (SC) had decided accordingly.

Hence, what comes out is that –

A. Interest at pre-commencement stage is a revenue receipt incase idle or surplus funds are parked in FDs and interest generated thereon - **Tuticorin Alkali Chemicals and Fertilizers Ltd. Vs. CIT,** (1997) 227 ITR 172 (SC).

B. Interest at pre-commencement stage is a capital receipt incase assessee receives any amount which is inextricably linked with the process of setting up of its plant & machinery, like providing BGs for the same - **CIT VS. Bokaro Steel Ltd.** (1999) 236 ITR 315 (SC)

The matter in the case of **ACIT Vs MB POWER (MADHYA PRADESH) LTD [2024-VIL-1748-ITAT-DEL]**, was remanded back though to check the facts.

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