Direct Tax Vista

Your weekly Direct Tax recap

Edn. 45 – 14th February 2023

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1. Battle on Freebies to doctors before AY 2010-11: 'Reason' is the link between 'conclusion' and 'evidence' for reopening assessment; Law applicable in relevant AY to be applied only

While re-opening assessments, the reasons recorded should be clear and unambiguous and should not suffer from any vagueness. Reasons provide the link between evidence and conclusion. Reasons are based on evidence which lead to a conclusion that some income has escaped assessment and due to which the same should be re-opened. This reason should disclose the fact and material not disclosed by the assessee fully and truly. The same was held by The Bombay High Court In the case of Hindustan Lever Ltd. Vs. R.B. Wadkar, Assistant Commissioner of Income-Tax and Others [2004 ITR 332 Vol.268].

As far as 'freebies' to doctors being disallowed as per Circular No.5/2012 is concerned, the same referred to the position of the regulations of 2002 after its amendment in the year 2009 and, therefore, neither the circular nor regulation 6.8 incorporated w.e.f. 10 December 2009 would apply to cases pertaining to earlier assessment years.

In the case of Apex Laboratories (P) Ltd. Vs. Deputy Commissioner of Incometax LTU [[2022] 135 taxmann.com 286 (SC)], where the assessee being a pharmaceutical company had incurred expenditure by giving freebies to the medical practitioners and accordingly, claimed exemption for the said expenditure under Section 37(1) of the Act for the assessment year 2010-11; The assessing offcer partially allowed the exemption claimed by the assessee on the expenses so incurred by placing reliance upon Circular No.5/12. The CIT (Appeals), Tribunal, as also the jurisdictional High Court upheld the said Order and subsequently, also by the Apex Court. However, in the aforementioned case, the claim before the Apex Court

pertained to the assessment yea 2010- 11, to which amendment incorporated in the Regulations 2009 was squarely applicable. The second thing which needs to be highlighted is that in the aforementioned case, the revenue had permitted partial exemption for expenses incurred till 14 December 2009 and held the assessee eligible for the benefit under Section 37(1) but disallowed the expenses incurred thereafter in view of the amendment of 2009. The Apex Court in fact in the judgment Apex Laboratories (P.) Ltd. (supra), has also clearly held that “the CBDT Circular being clarifcatory in nature and was in effect from the date of implementation of Regulation 6.8 of 2002 Regulations, i.e. from 14 December 2009. Hence, law to be applied is the one that is in force in the relevant assessment year, unless otherwise provided expressly or by necessary implication - CIT Vs. Insthmian Steamship Lines [[1951] 20 ITR 572 (SC)] and Reliance Jute & Industries Ltd. Vs. Commissioner of Income-tax [[1979] 2 Taxman 417 (SC)].

On the basis of the above the re-opening in the case of ABBOTT INDIA LIMITED Vs THE ASSISTANT COMMISSIONER OF INCOME-TAX [2023-VIL-22-BOM-DT], was quashed.

2. Any ad-hoc determination of ALP by TPO de-hors Section 92C(1) of the Act cannot be sustained

Section 92C(1) of the Act, contemplates that the arms length price in relation to an international transaction shall be determined by comparable uncontrolled price method; resale price method; cost plus method; profit split method; transactional net margin method or such other method as may be prescribed by the Board. Hence, the TPO is bound to determine the ALP by following one of the prescribed methods. Any ad-hoc determination of arms length price by the Ld TPO u/s section 92 de-hors section 92C(1) of the Act cannot be sustained. The contention is further supported by the judgment of the Hon'ble jurisdictional High Court in the case of Commissioner of Income Tax vs. Merck Ltd. 389 ITR 70 (Mum). In the said case the Hon'ble High Court decline to interfere with the findings of the Mumbai Bench of the Tribunal that the transfer pricing adjustment made by the TPO without following one of the prescribed methods makes the entire transfer pricing adjustment unsustainable in

law. The grievance of the revenue was that the consideration paid to the AE is only attributable to the services received / availed.

Even incase the benchmarking done by an assessee is not correct, the Transfer Pricing Officer should benchmark the AE payments by applying any of the prescribed methods. However, without applying any prescribed method incase he simply determines the arm's length price of AE payments, the approach would be considered as not being in accordance with statutory provisions, hence, unsustainable.

In the case of BRINKS INDIA PRIVATE LIMITED Vs DY. COMMISSIONER OF INCOME TAX CENTRAL [2023-VIL-189-ITAT-MUM], The international transaction which was subject matter of dispute was 'management fees' paid by the assessee to its AE. To benchmark the transaction the assessee relied on "other method". The Transfer Pricing Officer (TPO) following the decision in assessment year 2012-13 and 2013-14 applied CUP as the most appropriate method and thus, made adjustment. The DRP relied on the decision in similar issue in earlier AYs. It was decided that where TNMM method was applied and accepted in earlier years in respect of management fees paid/payable by the assessee to its AE, the TPO cannot summarily reject the TNMM and propose an adjustment under the CUP method, without benchmarking with comparable on a separate basis. Incase this is done, it would be considered that the TPO has resorted to an ad-hoc unilateral pricing of management fees, disregarding the facts and circumstances of the case.

3. The Court may relax latches incase a professional misleads

The Doctrine of Laches emanates from the principle that the Courts will not help people who sleep over their rights and helps only those who are aware and vigilant about their rights. A party is said to be guilty of laches when they come to the Court to assert their rights after a considerable delay in that respect. In Trilok Chand Motichand v. H.B. Munshi, the main question before the Court was whether there is any period of limitation prescribed within which the remedy under Article 32 is to be invoked. The petition, in this case, was filed after a delay of 10 years; the plea was dismissed for delay. The judges who comprised the bench in this case however

differed with respect to the time period after which laches should apply. One opined that three years will be the proper yardstick for measuring a reasonable time for preferring a writ petition. One put it as one year. One Justice suggested that the law on limitation has no application on the proceedings that take place under Article 32 and as such the Court cannot refuse a petition based on delay. However, Chief Justice Hidayatullah felt that no hard and fast rule should be adopted. He stated that the issue should be dealt with by the Court on a case to case basis. The whole issue is dependent on what the breach of a fundamental right is, what the remedy is and why did the delay in question arise in the first place.

In the case of SHIKSHA FOUNDATION Vs DCIT CPC, BANGALORE [2023-VIL-191-ITAT-AHM], The question of law framed is that incase the assessee acts on behalf of the professional advice, can he be held guilty for defiance of any provision of law, particularly latches? It was decided that Incase it can be proved that the delay in filing of the appeal was on the advice of a professional, it would be considered that the delay is not attributable on the negligent/casual approach of the assessee. Further incase on merit the assessee has a strong case to succeed, the delay in filing the appeal by the assessee should be condoned and the issue should be decided on merit.

The Supreme Court has observed in numerous decisions, including Ramlal v. Rewa Coalfields Ltd. AIR 1962 SC 361, State of West Bengal v. Administrator, Howrah Municipality AIR 1972 SC 749 and BabutmalRaichandOswal v. Laxmibai R. Tarte AIR 1975 SC 1297, that the State authorities should not raise technical pleas if the citizens have a lawful right and the lawful right is being denied to them merely on technical grounds. The State authorities cannot adopt the attitude which private litigants might adopt. The authorities under the Act are under an obligation to act in accordance with law. Tax can be collected only as provided under the Act. If an assessee, under a mistake, misconception or on not being properly instructed, is over-assessed, the authorities under the Act are required to assist him and ensure that only legitimate taxes due are collected.

Further, one of the propositions of settled legal position is to ensure that a meritorious case is not thrown out on the ground of limitation. Therefore, it is necessary to examine, at least prima facie, whether the assessee has or has not a case on merits

4. Allowability of write off of CWIP expenses

A classic case followed by revenue where the question of law is regarding Allowability of write off of CWIP expenses is M/S. FAURECIA EMISSIONS CONTROL TECHNOLOGIES INDIA PRIVATE LTD. VERSUS DEPUTY COMMISSIONER OF INCOME TAX, COMPANY CIRCLE II (3) , CHENNAI [2016 (3) TMI 368 - ITAT CHENNAI]. In this case, assessee incurred an expenditure towards setting up a factory at Singur in West Bengal. Due to unrest and protest by the local people, assessee had abandoned the said project, and claimed it as a revenue expenditure as a business expenditure. It was held that the expenditure incurred by the assessee is not for the purpose of carrying on its business, but on the other hand it is incurred for the purpose of setting up of new business which is in capital filed. It was decided that the expenditure incurred to set up a project at Singur in West Bengal is not an expenditure wholly and exclusively incurred for the purpose of carrying on business of the assessee or incidental o the carrying on the business of the assessee and it is an expenditure incurred in the capital field and it also cannot be allowed u/s.37 of the Act. Thus, the loss in respect of discarded project had written off by the assessee during the previous year is not allowable expenditure as business deduction and it cannot be allowed.

However, it has to be noted that the law has evolved on the crucial principle that the distinction between capital and revenue expenditure should be determined from the practical and business view point and in accordance with sound accountancy principles, eschewing the legalistic approach.

In the case of CIT-3 Vs. Idea Cellular Ltd. [2016 (10) TMI 181 - BOMBAY HIGH COURT], the Court held that where new cellular towers were constructed by cellular operator in addition to existing tower and no new business was set up, if project was abandoned, expenditure so far incurred would be allowed as business

expenditure. Hence, if an expenditure is incurred for doing the business in a more convenient and profitable manner and has not resulted in bringing any new asset into existence, then, such expenditure is allowable business expenditure, even incase capitalised and then written off later.

In the case of Principal CIT vs. Rediff.Com India Ltd. [2022] 441 ITR 195 (Bom) Date of order: 29th September, 2021, the issue was that the assessee abandoned some of its incomplete website projects, which were not expected to pay back and wrote off expenses on account of capital work-in-progress pertaining to such abandoned projects and claimed deduction thereof as revenue expenditure u/s 37 of the Income-tax Act, 1961. The Assessing Officer held that the expenditure was incurred for creating new projects and represented capital assets of its business that were to yield enduring benefit and that by claiming such expenditure under the head 'capital work-in-progress', the assessee itself had admitted that those expenses were capital in nature and disallowed the assessee's claim of writing off 'capital work-in-progress'. The Tribunal held that the expenses incurred were in connection with the existing business and were of routine nature, such as salary and professional fees, and that the expenses were revenue in nature and allowed the assessee's claim. On appeal by the Revenue, the Bombay High Court upheld the decision of the Tribunal and held that The Tribunal's view that if an expenditure was incurred for doing the business in a more convenient and profitable manner and had not resulted in bringing any new asset into existence, such expenditure was allowable business expenditure u/s. 37 was correct. The expenditure incurred was on salary and professional fees which was revenue in nature and did not bring into existence any new asset. There was no perversity or application of incorrect principles in its order. No question of law arose."

On similar grounds it was held in the case of AXIS TECHNICAL GROUP INDIA PVT. LTD. Vs DCIT, CIRCLE-1(1), PUNE [2023-VIL-169-ITAT-PNE]. The issue was that the assessee had capitalized certain revenue costs in respect of certain modules which it was trying to use in the software development business, but abandoned them during the year under consideration. It was held that costs incurred earlier on such modules, which are otherwise of revenue nature, cannot be treated as capital

expenditure, incapable of deduction on their write off. Rather it is a case of incurring revenue expenditure, which was initially capitalized and now written off because of abandoning the modules, that were no more required in the software development business. The cost of salary and computer rent is eligible for deduction. The ground of appeal was allowed.

5. Section 206AA of the Act cannot have overriding effect on DTAA: TDS on payment made to NRI who did not furnish PAN can be made as per rate in DTAA

The issue is that in case of payments made by the assessee to non-residents, whether in the absence of PAN of the non-resident payees, the assessee is permitted to deduct taxes at the rate mentioned in the Tax Treaty with the respective countries or is still under an obligation to deduct taxes under section 200AA of the Act at a higher rate of 20%. In this regard, the Hon'ble Supreme Court in the case of Union of India v. Azadi Bachao Andolan [2003] 263 ITR 706/132 Taxman 373 has upheld the proposition that the provisions made in the DTAAs will prevail over the general provisions contained in the Act to the extent they are beneficial to the assessee. Even the charging section 4 as well as section 5 of the Act which deals with the principle of ascertainment of total income under the Act are also subordinate to the principle enshrined in section 90(2). Hence it would be incorrect to say that though the charging section 4 of the Act and section 5 of the Act dealing with ascertainment of total income are subordinate to the principle enshrined in section 90(2) of the Act but the provisions of Chapter XVII-B governing tax deduction at source are not subordinate to section 90(2) of the Act. In the context of section 195 of the Act also, the Hon'ble Supreme Court in the case of CIT v. Eli Lily & Co. [2009] 312 ITR 225/178 Taxman 505 observed that the provisions of tax withholding i.e. section 195 of the Act would apply only to sums which are otherwise chargeable to tax under the Act. The Hon'ble Supreme Court in the case of GE India Technology Center (P.) Ltd. v. CIT [2010] 327 ITR 456/193 Taxman 234/7 taxmann.com 18 held that the provisions of DTAAs along with the sections 4, 5, 9, 90 & 91 of the Act are relevant while applying the provisions of tax deduction at source. Thus, section 206AA of the Act cannot be understood to override the charging sections 4 and 5 of the Act.

There are a catena of other judgements in this aspect. This issue was also discussed at length by the ITAT in the case of Serum Institute of India Ltd.[2015] 56 taxmann.com 1 (Pune - Trib.), wherein the ITAT held that TDS on payments made to non-residents who did not furnish their PAN can be deducted as per rate prescribed in DTAA and section 206AA cannot be invoked to insist on tax deduction at rate of 20 per cent.

Thus also it was decided in the case of THE DCIT, (INTA . TAXA)-I, AHMEDABAD Vs ADANI WILMAR LTD. [2023-VIL-167-ITAT-AHM] that the provision of TDS are to be read along with DTAA for computing the TDS liability and when the recipient is eligible for benefit to DTAA, the addition on the ground of short deduction of TDS applying the provision of 206AA is not correct.

In the case of Danisco India (P.) Ltd.[2018] 90 taxmann.com 295 (Delhi), the Delhi High Court held that where assessee, an Indian remits payments to company located in Singapore which is not a tax assessee in India, and tax relationship between two countries is regulated in terms of Indo-Singapore DTAA, rate of taxation would be as dictated by provisions of treaty and not under section 206AA.

In the case of Infosys Ltd. v DCIT [2022] 140 taxmann.com 600 (Bangalore - Trib.), the ITAT held that if rate of tax applicable under DTAA is lower than 20 per cent tax rate as prescribed under section 206AA, TDS has to be deducted at such lower rate even if non-resident deductee fails to furnish its PAN.

The Special Bench of the Tribunal in the case of Nagarjuna Fertilizers & Chemicals Ltd. v. Asstt. CIT [2017] 78 taxmann.com 264 (Hyd.) had held if rate of tax applicable under DTAA is lower than 20 per cent tax rate prescribed under section 206AA, TDS has to be deducted at such lower rate even if non-resident deductee fails to furnish its PAN.

In the case of Wipro Ltd. [2017] 88 taxmann.com 435 (Bangalore - Trib.), the ITAT held that provisions of TDS should be read along with provisions of DTAA for

computing tax liability of non-resident; when nonresident is eligible for benefit of DTAA on sum in question, there is no scope for deduction of tax at source at 20 per cent as provided under provisions of section 206AA.

In the case of Uniphos Environtronic (P.) Ltd. v. DCIT [2017] 79 taxmann.com 75 (Ahmedabad - Trib.), the jurisdictional Ahmedabad ITAT held that where tax had been deducted on fee for legal services to a German company on strength of beneficial provisions of DTAA, provisions of section 206AA could not be invoked because section 90(2) provides that provisions of Act shall apply to the extent they are more beneficial to assessee.

In the case of Jyoti Ltd. v. DCIT [2021] 127 taxmann.com 596 (Ahmedabad - Trib.), the Ahmedabad ITAT held that section 206AA does not override provision of section 90 and, thus, TDS had been rightly deducted by assessee on payment made to non-resident by applying tax rate prescribed under DTAA and not as per section 206AA.

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