Direct Tax Vista

Your weekly Direct Tax recap

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1. The AOs should take responsibility of Sec 154 cases so that these do not meet unfavourable judgements at the appellate stage

The legal contours of an error apparent on the face of the record cannot be exactly identified, but there has to be an application of mind by the AO while invoking Section 154, when a Revenue Audit objection is accepted by the department. Question is that what are “records” and what are “Mistakes apparent”, for the AO to apply Sec 154. In various cases it has been concluded that the records of the case comprising the entire proceedings including documents and materials produced by the parties and taken on record by the authorities which were available at the time of passing of the order which is the subject-matter of the proceedings for rectification are to be considered as records. Mistakes on the other hand which can be considered apparent are Arithmetical errors, Clerical errors, Misreading of any provision of law, Application of wrong provision of law.

An error which has to be established by a long-drawn process of reasoning on points where there may conceivably be two opinions can hardly be said to be an error apparent on the face of the record. Where an alleged error is far from self-evident and if it can be established, it has to be established, by lengthy and complicated arguments, such an error cannot be said to be apparent from records.

In cases where Revenue objection is accepted, it is noticed that the AO is frequently using section 154, even in cases where there is no mistake apparent from records or where action under section 263/147 is necessary. This leads to unfavorable judgments at the appellate stage, which could have been avoided. Even If Pr. CIT chooses not to use section 263, the Assessing Officer (AO) is obligated to evaluate

the case's facts and take the appropriate action based on his independent judgment. Application of mind by the AO is important in these cases.

Vide Instruction F. No. 246/06/2023, dated 16-02-2023, The Central Board of Direct Taxes (CBDT) has requested all tax officers to ensure that the procedure prescribed in Instruction no. 7/2017 is followed scrupulously and remedial action is taken after due application of mind. Instruction no. 7/2017 prescribes the procedures for invoking section 263/154 if a revenue audit objection is accepted. In accordance with the said procedure, the Principal Commissioner of Income Tax (PCIT) must determine whether the order in question, which prompted the objection, requires revision under Section 263. This decision should be based on the facts of the case and will depend on whether the objection is acceptable.

Thus, the CBDT has requested all field authorities to ensure that the procedure prescribed in Instruction No. 7/2017 is followed scrupulously and remedial action is taken under the appropriate section of the Income-tax Act after due application of mind.

Indirectly, vide this instruction a message has been sent to the AOs to take responsibility of cases where they apply Section 154. Incase they choose to do so, then they should also have sufficient reasons on record so that the cases are not rejected at the appellate stage on the basis of mis-application of Section 154.

2. TNM Method not appropriate in determining ALP in capital goods purchase transaction

Transfer pricing provisions kick in only when an income is charged to tax under other provisions of the IT Act. In the case of Vodafone India Services (P.) Ltd. V. UOI [2014] 50 taxmann.com 300 (Bombay) (HC), it was held that in its normal meaning 'income' will not include capital receipts unless it is so specified in Section 2(24) of the IT Act. Neither Section 2(24)(vi) read with Section 45 nor clauses (vii), (ix) and (x) of sub-section (2) of Section 56 define purchase of depreciable capital assets to be income. Hence such a question arises.

An income arising from an international transaction must satisfy the test of income under the Act and find its home in one of the above heads i.e. charging provisions, as Chapter X is only a machinery provision to compute the chargeable income at ALP. Machinery section cannot be read de-hors the charging section, relying on the observations of the Supreme Court in CIT v. B. C. Srinivas Shetty 128 ITR 294.

Further, the CBDT vide Instruction No. 02/2015, dated 29 January 2015 has notified that it has accepted the decision of Vodafone IV and has directed that the ratio decidendi of the judgment must be adhered to by the field officers in all cases where this issue is involved.

However, According to the Explanation to sub-section (2) of Section 92B, a transaction of purchase of fixed asset is also an international transaction. Since Section 92 is not a charging section but a procedural provision for re-computing the income, there must be some existing income chargeable to tax before applying TP provisions. If there is an international transaction in the capital field not giving rise to any income in itself then, no adjustment can be made for the difference between the declared value and the ALP of such international transaction. Computation of ALP is necessary because of the impact of such a transaction on the revenue offshoots, i.e. depreciation charge which goes into the computation of income. In such cases, depreciation must be based on the ALP of such assets. Hence, the obligation to determine ALP in the case of purchase of depreciable capital asset arises only when depreciation is claimed. However, this will not relieve the person from his obligation to maintain information as stipulated in Section 92D and the relevant rules of the Income Tax Rules, 1962 because Section 92D obliges a person who enters into an international transaction to maintain information in respect of such international transaction.

Now the question is the method to be used for determining ALP in transaction of purchase of Capital Goods. Since the purchase of capital goods does not enter Profit and Loss account (except depreciation on those assets), the TNM method is not appropriate. The Hon’ble Mumbai ITAT in the case of OWENS-CORNING (INDIA) PVT. LTD Vs DCIT, CIRCLE 7(1) [2023-VIL-284-ITAT-MUM] was of the view that the

foreign AE can be selected as a tested party, the margin earned by AE from the transactions entered with non-AEs may be relevant.

3. The Court may throw a meritorious case for latches if filing is an afterthought

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 Babutmal Raichand Oswal 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.

However, one needs to substantiate that there is a genuine delay and not a made up after thought. In the case of M/s GREATER KAILASH HOSPITALS PVT. LTD Vs

ACIT 2(1), INDORE (MP) [2023-VIL-280-ITAT-IND], additional income was admitted during an assessment and after that a consultant explained to the assessee that additional income was offered to tax even though source of amount as advanced was duly explained from the cash as available in the regular books of account of the company and assessee it was advised to file an appeal before the Tribunal at the earliest. The delay of 156 days was explained due to this reason and sought to be condoned. Further, all the four grounds raised in the revised form No.36 were additional grounds as the same were never agitated before the ld.CIT(A) in Form No.35 and these were sought to be admitted as per the proposition rendered by the Hon'ble Supreme Court in the case of National Thermal Power Corporation Ltd. (1998) 97 taxman 358 (SC). In this case the ground were considered inadequate, not a sufficient and plausible cause for the delay of 156 days in filing the appeal before the Tribunal, relying on the case of Collector Land Acquisition, Anantnag & Anr. vs Mst. Katiji & Ors, judgement dated 19 February, 1987, reported in 1987 AIR 1353, where their Lordships, speaking for the Hon'ble Supreme Court, categorically held that the onus is on the assessee to explain by way of sufficient and plausible cause the delay in filing the appeal.

4. Section 68 for unexplained credit before and after amendment by FA 2022

Section 68 of the Act provides that where any sum is found to be credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.

The onus of satisfactorily explaining such credits remains on the person in whose books such sum is credited. If such person fails to offer an explanation or the explanation is not found to be satisfactory then the sum is added to the total income of the person.

Vide Finance Act, 2012, it was provided that the nature and source of any sum, in the nature of share application money, share capital, share premium or any such amount by whatever name called, credited in the books of a closely held company

shall be treated as explained only if the source of funds is also explained in the hands of the shareholder. However, in case of loan or borrowing, courts have held that only identity and creditworthiness of creditor and genuineness of transactions for explaining the credit in the books of account is sufficient, and the onus does not extend to explaining the source of funds in the hands of the creditor. This was considered to have led to the provision becoming ineffective in handling evasion when routed through a layered credit claim. Therefore, the provisions of section 68 of the Act had been amended by FA 2022 so as to provide that the nature and source of any sum, whether in the form of loan or borrowing, or any other liability credited in the books of an assessee shall be treated as explained only if the source of funds is also explained in the hands of the creditor. However, this additional onus of proof of satisfactorily explaining the source in the hands of the creditor, would not apply if the creditor is a Venture Capital Fund, Venture Capital Company registered with SEBI.

However even before this amendment, to escape from rigors of Section 68 of the Act, onus was always on shoulders of assessee to explain source of share application money received by it from investor companies. Where Assessee did not furnish details and particulars showing identity of investor companies, their capacity and credit worthiness and genuineness of transaction and main contention of assessee was only that assessee is a conduit company which received amount from 40 investors and further invested same to its main group company and impugned amount has already been taxed in hands of the main group company, the same was rejected. In the case of DHANWAN LEASING AND FINANCE COMPANY LTD Vs ITO, WARD 2(2), INDORE [2023-VIL-279-ITAT-IND] it was held that for establishing a factum of conduit company, the assessee is duty bound to establish that source companies are also group companies and assessee after receiving the amount further invested same by making investments in group company. Investor companies, who invested amount in assessee company as share application money, are not part of main group company. Assessee had also onus to prove that it is a conduit company and also establish identity, capacity and credit worthiness of investor companies and genuineness of transaction.

Hence, now after amendment of Section 68, the onus is on the assessee to establish the following –

1. The source of funds is also explained in the hands of the creditor.
2. Identity, capacity and credit worthiness of the creditor

5. Where unexplained income cannot be entangled in the clutches of The Section 69 family

Sections 68, 69, 69A, 69B, 69C and 69D may be called as Section 68 & 69 Family. However, they differ in as far as Burden of Proof is concerned. In sec 68, the onus is wholly upon the Assessee to explain the source of the entry. But in cases falling under sec 69, 69A, 69B and 69C, the words used show that before any of these sections are invoked, the condition precedent as to existence of investment, expenditure, etc. must be conclusively established by material on record/ evidence. Section 101 of The Indian Evidence Act, 1872 specifies that Whoever desires any Court to give judgment as to any legal right or liability dependent on the existence of facts which he asserts, must prove that those facts exist. When a person is bound to prove the existence of any fact, it is said that the burden of proof lies on that person.

In Mad HC in N Swamy 241 ITR 363 relied by Chennai ITAT in Omega Estates and Chd ITAT in Dr. R.L.Narang, it was held that The burden of showing that the assessee had undisclosed income is on the revenue.

In ITO vs. Mrs. Deepali Sehgal (ITAT Delhi), ITA No. 5660/Del/2012, the AO noted that assessee had withdrawn huge cash from bank account and the same amount had been deposited to the same account after lapse of substantial time. The AO rejected the explanation and held that the assessee had cash deposit of Rs.24,38,000/- as unexplained money and the assessee found to be the owner of the money as he had not offered any acceptable and cogent explanation. AO, in his remand report could not bring out any fact that the cash withdrawn from Saving Bank Account and partnership overdraft account was used for other purpose anywhere else then, merely because there was a time gap between withdrawal of cash and its further deposit to the bank account, the amount cannot be treated as

income from undisclosed sources u/s 69 of the Act in the hands of the assessee. Hence, the addition made by AO without any legal and justified reason was rightly deleted by the CIT (A).

The provisions of section 115BBE of the Income Tax Act are applicable where addition is made under section 68,69,69A, 69B, 69C & 69D i.e. from residuary category w.e.f. 01/04/2017.

Where the assessee includes surrendered amount of excess stock and excess cash in the return of income filed in response to notice u/s 153A of the Act and it was accepted, no further addition u/s 69A or 69B of the Act can be made against the assessee.

In the case of ACIT vs. Shri Anoop Neema, reported as 2022 (1) TMI 683-ITAT Indore, the alleged excess stock was admitted as a part of the total business stock found at the assessee's business premises. It was considered as sufficient to indicate that the alleged investment in excess stock is part of the business income and that allege excess stock accepted by the assessee as part of unaccounted business and source thereof stated during the course of search itself and no other incriminating material was found during the search proceedings and, thus, the same cannot be treated as income from undisclosed source of income and the Ld. CIT(A) was right in holding that the provisions of section 115BBE of the Act are not applicable on the surrendered income on account of excess stock valuing found during the course of search.

Where the assessee has successfully explained that the excess stock & excess cash was nothing but business income of assessee and The CIT(DR) could not dislodge the contention and observations that the surrendered amount was pertaining to excess stock & excess cash which was business income of the assessee, the impugned income will not be entangled in the clutches of Section 69/69A/69B of the Act and therefore do not warrant application of Section 115BBE of the Act at all. The same was held in the case of DCIT(CENTRAL)-2 INDORE Vs SHRI KRISHNA KUMAR VERMA [2023-VIL-283-ITAT-IND]

6. IT Dept issues Instructions on dissemination of High-Risk transaction and High-Risk Non-PAN Transaction cases on Verification module of Insight portal

The Directorate of Income Tax (Systems) has issued Instructions vide F. No. DGIT(S)-ADG(S)-2 / High Risk Transaction (Pan and Non-PAN) cases/2022-23/11914 dated February 20, 2023 regarding the dissemination of High-Risk transaction and High-Risk Non-PAN Transaction cases on Verification module of Insight portal (RMS Cycle-2). The Board approved Risk Management Strategy (Cycle-2) has been executed for the identification of potential cases for action u/s. 148/148A of the Income Tax Act, 1961. Verification Initiation Date would be examined in cases being disseminated under RMS Cycle-2 and accordingly, appropriate action would be initiated in accordance with the relevant provisions u/s 148A/148. Such assesses should thus be on the alert.

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