Direct Tax Vista

Your weekly Direct Tax recap

Edn. 56 – 3rd May 2023

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1. Asian Countries Tax Data Exchange Treaty gains further ground

Data exchange is not only happening within India, but also globally now and it is increasingly gaining strength as Trade goes global. All 22 Asian members of the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) are implementing the transparency and exchange of information on request (EOIR) standard and 16 of them are committed to starting automatic exchange of financial account information (AEOI) exchanges by 2024. Through the Asia Initiative, launched at the end of 2021 under the Indonesian G20 Presidency, 16 Asian countries had signed up to the Bali Declaration by the end of 2022.

As Governments exchange Data and set up sophisticated systems of data analytics, MNCs should also prepare for this transformation in global business environment and keep their explanations ready for the international and intra-group transactions entered into.

2. Determining the 'basis' of share of revenue in a contracting state

There is always a question on what is the reasonable basis to determine the share of revenue of a contracting state. Lets understand the issue and the matter of law or fact involved -

Explanation 1(a) to Section 9(1)(i) states as follows –

> *"9. Income deemed to accrue or arise in India*
> *(1) The following incomes shall be deemed to accrue or arise in India:*
> *(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in*

India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Explanation 1-For the purposes of this clause— (a) in the case of a business other than the business having business connection in India on account of significant economic presence of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India."

"Article 7 of the DTAA between USA and India states as follows –

Business Profits –
1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to

(a) that permanent establishment ;
(b) sales in the other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment ; or
(c) other business activities carried on in the other State of the same or similar kind as those effected through that permanent establishment."

Under Explanation 1(a), what is reasonably attributable to the operations carried out in India alone can be taken to be the income of the business deemed to arise or accrue in India. What portion of the income can be reasonably attributed to the operations carried out in India is a **question of fact and has to be determined in each case**. Article 7 of the DTAA also lays down the same principle.

Hence once the assessee establishes scientifically through means which can be on the basis of proportion in 'value of assets' used in providing service in India or the proportion of 'manpower' used in India, then the revenue has to come out with an

acceptable argument against the basis ascertained for the Courts to look into the case. The recent decision of The Apex Court in the case of DIRECTOR OF INCOME TAX, NEW DELHI Vs TRAVELPORT INC [2023-VIL-17-SC-DT] lays down the proposition which can be used by assesses going forward.

3. In an 'unabated assessment order', no addition u/s 153A can be made unless there is some incriminating material w.r.t. the addition made by the AO

The provisions of sec.153A of the Act provide for issuing of notice u/s 153A of the Act for 6 assessment years immediately preceding the year of search and thereafter, the AO shall assess or reassess the total income for the above said 6 years. This section further provides that all pending assessment or reassessment pending as on the date of search shall abate. Hence the assessments of the assessment years falling within the period of above said 6 years which are not pending, i.e., which have attained finality shall not abate. Assessments of such assessment years are called "unabated/completed/finalized" assessments. The question earlier was whether the AO is entitled to interfere with such kinds of unabated/completed/ finalized assessments or not without there being any incriminating material found during the course of search.

It is now a settled principle now that in respect of non-abated assessments, the assessment will be made on the basis of books of account or other documents not produced in the course of original assessment but found in the course of search and undisclosed income or undisclosed property discovered in the course of search. However, in case of completed assessments, the assessment u/s. 153A has to be made on the basis of incriminating material only, i.e., undisclosed income / property / books of accounts/documents. Where nothing incriminating is found in the course of search relating to any of the assessment years covered u/s.153A of the Act, the assessment for such A.Ys. cannot be disturbed and the completed assessment has only to be reiterated.

Important point is that there must be "incriminating material" to support the allegations like bogus purchases, job works, subcontract works, labour expenses, addition of unsecured loans and interest disallowance, etc. Incase these allegations

are without any incriminating material or the incriminating material is without substance not being contrary to and/or not disclosed during regular assessment proceedings, then 153A cannot be resorted to. The proposition was again reiterated in the case of THE DCIT, CENTRAL CIRCLE 5(1) Vs M/s SAKET INFRA PROJECTS PVT LTD [2023-VIL-544-ITAT-MUM].

4. Exemption to trusts u/s 12A to continue on the basis of doctrine of 'consistency'

Incase the Income Tax Act in the year of Registration did not mandate the requirement of issuance of a registration certificate, the same cannot be insisted upon and the application of registration itself should be considered to be due compliance of law. However, the question arises that if there was an amendment to the law and which required the issuance of the certificate of registration under Section 12A and still exemption continued to be granted year-on-year without an RC, can thereafter the exemption be denied just because there existed to RC for earlier years?? This is a question which is haunting many NPOs/ Trusts. This question has been answered by The Apex Court in the decision of M/s MAHARISHI INSTITUTE OF CREATIVE INTELLIGENCE U.P. LUCKNOW Vs COMMISSIONER OF INCOME TAX (EXEMPTION) LUCKNOW [2023-VIL-16-SC-DT]

It was held that what was required to be considered was the relevant provision prevailing in the year RC was applied for. At the relevant time incase there was no requirement of issuance of any certificate of registration, the benefit of exemption under Section 12A for subsequent years ought to be granted.

5. AO cannot accept the assessee's method of accounting on the one hand and determine the value of stock on another method – 'hybrid accounting method' cannot be used

AOs can sometimes ask the work contractors to recast their Financial statement relying upon "project completion method" instead of "percentage completion method" or vice-versa. However they cannot use a 'hybrid accounting method' wherein they take the closing stock of one method and the other figures from another method. In the case of PANCHSHEEL COLONIZERS PRIVATE LIMITED Vs INCOME TAX OFFICER JAIPUR [2023-VIL-536-ITAT-JAI], although the assessee was

regularly following project completion method of accounting, but as per direction of AO, assessee submitted recasted Balance Sheet and Profit and Loss account as per percentage completion method. On perusal of this recasted profit and loss account, AO observed that loss is more and therefore, he has accepted loss as declared by assessee but valued the closing stock based on the recasted balance sheet. This was declared unacceptable by the Tribunal and the AO was directed to accept the original value of the closing stock.

6. "MESNE Profits" for capital asset is capital receipt

'Mesne Profits' is defined under section 2(12) of Code of Civil Procedure 1908. It takes within its scope any receipt against wrongful possession of property. The question is whether these receipts are capital receipts or revenue receipts. When the court decrees mesne profits, that decree is in recognition of the position that the true owner is entitled to the income from the property and the person in wrongful possession is to compensate the true owner in that regard by paying either the actual income from the property or a reasonable estimate of that income.

The nature of deprivation suffered by the assessee is crucial for the purpose of determination of nature of receipt of mesne profits. Where the compensation is paid for deprivation of capital asset, or source of income, it would be a capital receipt in the hands of recipient of the compensation. On the other hand, where the sums are awarded by the court in the nature of restitution of interest, dividend or any other yield, out of the property is contrast to awarding compensation, the sum awarded is on the nature of income."

Hence, mesne profits are a species of taxable income. However it derives its colour from nature of deprivation. The same was held in ACIT 25(2) MUMBAI Vs AMRUT ENTERPRISES [2023-VIL-533-ITAT-MUM].

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