Direct Tax Vista

Your weekly Direct Tax recap

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1. Income Tax bitter pill for the business of prescription of medicines

Not every doctor is corrupt and not every pharmaceutical firm resorts to unethical means to sell their products. However, there is no denying that a large number of doctors and medical companies adopt unfair means. Even the Supreme Court frowned at the expenses incurred on sales promotion of certain medicines. The Hon'ble Supreme Court in the case of Apex Laboratories (P.) Ltd. 135 taxmann.com 286 (SC) vide order dated February 22, 2022, held that since acceptance of freebies by medical practitioners was punishable as per Circular issued by Medical Council of India under MCI regulations, 2002, gifting of such freebies by assessee pharmaceutical company to medical practitioners would also be prohibited by law and thus, expenditure incurred in distribution of such freebies would not be allowed as a deduction in terms of Explanation 1 to Section 37(1)of the Income Tax Act.

Now consider a case of pharma trading assessee –

A. Sales of assessee - Rs.4.6 Crs
B. GP - Rs.1 Cr
C. Amount paid as commission to doctors - Rs.50 Lakhs.

The figures tell a story and The Circular No. 5 of 2012 dated 01.08.2012, prohibits the aforesaid commission payments since they are in violation of the provision of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulation, 2002 and therefore are not admissible under Section 37 of the Act. Nonetheless, lets understand the argument of the assessee –

A. The Circular speaks about freebies and the same is not applicable to the case of assessee as the commission expenditure cannot be termed as freebies to doctors from pharmaceutical retail stores.
B. The aforesaid Circular is applicable to pharmaceutical industry and hence, the assessee is not covered within the scope of the aforesaid Circular.

However, it needs to be noted that cash or monetary expense which is not for any research, study, etc. through approved Institutions, paid by “allied health sector” also is included in the ambit of the Circular. Further the question is ‘what is the consultancy service rendered by the doctor’ to the pharma trading taxpayer. The mere fact of calling an activity a consulting activity and deducting TDS on the payment serves no purpose. On the contrary, the fact that the sales of the pharmacy being dependent primarily on the prescriptions made by the doctors to whom the commission was paid, point to the fact that the payment was in substance a sales promotion payment. Hence, it was held in the case of SUNFLOWER PHARMACY Vs INCOME TAX OFFICER [2023-VIL-1396-ITAT-AHM] that It was apparent that the Medical Council of India in exercise of the powers vested in it under the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 imposed prohibition on any medical practitioner or their professional associates from accepting any gift, travel facility, hospitality, cash or monetary grant from any pharmaceutical and allied health sector Industries. This regulation was a very salutary regulation which is in the interest of the patients and the public and hence once this comes into play, disallowance u/s 37 of Income Tax Act is invoked. These payments would thus be disallowed.

2. Domestic Companies availing benefit of 22% tax can filed Form 10-IC for AY 21-22 by 31st January 2024

Procedurally, Form 10-IC is required to be filed if a Domestic Company chooses to pay tax at concessional rate of 22% under Section 115BAA of the Income Tax Act. However, effective tax rate including cess and surcharge is 25.17%. Those companies that have not filed the Form 10-IC would have to pay as per I-T notices issued for 30% with Minimum Alternate Tax (MAT).

Many taxpayers over the years could not file the form and hence the benefit of the reduced rates was denied during assessments. They were thus running to appeals and hence for AY 2020-21 vide Circular No. 6/2022, issued on March 17, 2022 and now for AY 21-22 the CBDT by Circular No. 19/2023 dated Oct 23rd 2023 condoned the delay in filing of Form No. 10-IC as per Rule 21AE of the Income-tax Rules. However, to condone a procedural delay, the CBDT has required the pre-compliance of other procedural conditions as follows -

i. The return of income for AY 21-22 should have been filed on or before the due date specified under section 139(1) of the Act;
ii. The assessee company should have opted for taxation u/s 115BAA of the Act in item (e) of “Filing Status” in “Part A-GEN” of the Form of Return of Income ITR-6;

Incase the above conditions are satisfied, then Form No. 10-IC may be filed electronically on or before 31.01.2024 or 3 months from the end of the month in which this Circular is issued, whichever is later. It’s important for eligible companies to take advantage of this extension and ensure their filings are in order.

However, for companies who have not complied with the above 2 conditions, still the contest in courts will continue on the basis of the trite that a substantive right cannot be denied merely on the ground of procedural lapse. Procedure is merely a handmaid of justice. Laws and procedure are meant to regulate effectively, assist and aid the object of doing substantial and real justice. A plethora of verdicts are already available in the matter as per the case of Refac Corporation Rep. & Ors. Vs. The Nodal Officer & Four Others 2021 (12) TMI 1041 - Telangana High Court; Vimal Enterprise Vs. UOI 2006 (195) ELT 267 (Guj.); etc.

3. Overall prosperity and better distribution among Income Taxpayers; Compliance is improving too...but still work is to be done

Data released by the CBDT has revealed that there has been improved taxpayer compliance with 7.41 crore income tax returns being filed so far for assessment year 2023-24, including 53 lakh new, first-time filers. However, there are still a significant

number of taxpayers who have been brought under the tax net but do not file tax returns. Even as a total of 6.75 crore taxpayers filed income tax returns in assessment year 2021-22 (financial year 2020-21), a rise of 5.6% from 6.39 crore taxpayers in the previous year, additionally around 2.1 crore taxpayers paid taxes but did not file returns.

An important observation is that individual taxpayers are showing a positive trend of migration to a higher range of gross total income. Further, the proportionate contribution of the gross total income of the top 1% of individual taxpayers vis-à-vis all individual taxpayers has decreased from 15.9% in the assessment year 2013-14 to 14.6% in the assessment year 2021-22. This shows that the overall income of the taxpayers is increasing across all ranges. While this does show a positive trend for the Country, yet to facilitate more and more people come into the mainstream, it is felt that more work needs to be done to ease the litigation burden.

4. Role of PrCCIT (NaFAC) restructured to make faceless assessments procedure more robust

The CBDT has modified the order issued under section 119 vide F. No. 1 87/3/2020-ITA-I dated 31-03-2021, assigning the role of PR. CCIT (NaFAC) under Faceless Assessment Scheme 2019. The earlier Order in Para 3 required that The Pr. CCIT (NaFAC) would include interalia the following –

i. Formulating the roles & functions of various Income Tax Authorities posted in the ReFAC hierarchy.

ii. Ensuring that the computer systems with the ReFACs function properly and all the functionalities in this regard also function satisfactorily. It required that She/ he will be the interface between ReFACs and Directorate of Systems and advise the Board of appropriate action at appropriate time and in appropriate circumstances.

Now the above 2 roles have been de-assigned to The Pr CCIT(NaFAC), possibly to reduce the burden as well as make her/him focus on the NaFAC functions. Hence, she/he will not be responsible for the ReFAC.

However, an additional role has been assigned of "**Advising the Board for improvement of efficiency and effectiveness of faceless assessment processes**" The Other Roles assigned to Pr CCIT(NaFAC) would be as follows -

a. Overall implementation of the Board's Policy with respect to Faceless Assessment.
b. Formulating the Guidelines and SOPs required for the work to be done by the Assessment Units/ Verification Units/ Review Units/ Technical Units with prior approval of the Board.
c. Ensuring that the Technical Units provide a considered view on legal matters and provide technical support required for Assessment Units.

Over a period of time there have been a number of grievances in faceless assessments and hence a member in the board is now dedicated to faceless assessments procedures streamlining. The immediate effect of this order also demonstrates the urgency in implementing these changes to ensure that the issues under faceless assessments are streamlined further.

5. Where it can be proved that the source of cash payment has been out of known source of income, then addition u/s. 69C does not sustain

An often-followed modus operandi for booking bogus purchases is that the accommodating party receives cheques from the assessee towards purchase of goods or services and returns the money by cash after deduction a certain sum towards their fees or commission. To substantiate the same, statements are taken by the departmental officers during search conducted. However, what simultaneously needs to be checked is whether cash has been withdrawn from the bank and the balance in cash account. A reconciliation should be made as to the cash expenditures made, if any, out of this cash withdrawn. In the same vein, where incriminating documents (like diaries with figures of expenditures) are found, then again, the same should also be a part of the reconciliation. If this reconciliation is not made, then a 360 degree view cannot be obtained on the generation and utilization of cash. In such case where it can be proved that the source of said payment has been out of known source of income, then the question of making

addition towards said payments u/s. 69C of the Act, does not arise. The same was the case in the matter of M/s THE MADRAS PHARMACEUTICALS Vs THE ASSISTANT COMMISSIONER OF INCOME TAX [2023-VIL-1385-ITAT-CHE]

6. Understanding Income of Royalty and Fees For Technical Service

To understand royalty income and Fee from Technical service(FTS), lets understand the case of sale of computer wherein software is uploaded on the computer. For any problem in the computer, the seller enters into an agreement with the buyer through AMC. Whenever the buyer has any problem, he can access the software online and troubleshoot the problem. In some cases, the buyer does the same through the vendor or vendor's engineers. The engineers, of the vendor, contacts the engineers of the manufacturer online or telephonically to dissolve the issue. In such case, if the manufacturer of computer is situated outside India, then the services provided by it through vendor cannot be treated as FTS / Royalty. The same ratio was applied in the case of ASSISTANT COMMISSIONER OF INCOME TAX Vs M/s JUNIPER NETWORKS INTERNATIONAL [2023-VIL-1387-ITAT-MUM].

To be taxable as royalty income covered by Article 12 of DTAA, income of assessee should have been generated by "use of or right to use of any copyright". Further to be taxable as fees for technical Services rendered by assessee, a technical knowledge has to be “made available” that would enable the recipient to resolve technical issues independently in future. Applying the ratio of the example discussed above incase of a computer, merely authorizing or enabling a customer, with an End User License Agreement, to have benefit of data or instructions contained therein without any further right to deal with them independently does not amount to transfer of rights in relation to copyright, nor does it make available the technical knowledge to resolve issues independently in future. Mere access to a software to troubleshoot problems without right to own or reproduce cannot be construed as granting a right to utilize copyright embedded in software. Hence, payment received by in this regard cannot be taxable in India.

7. Section 263 can be invoked only when incriminating evidence was unearthed during search, or unabated assessments are erroneous nor prejudicial to interest of revenue

The jurisprudence in the matter of invocation of Section 263 is quite settled, but still cases are argued and we keep reporting. Share application money received is always under the ambit of scrutiny and one way of disallowing it is vide the route u/s 68 of the Income Tax Act by alleging that the payment was made on account of commission paid for acquiring bogus accommodation entry. However, as held in the case of ACIT (CENTRAL CIRCLE)-2 RAIPUR (C.G.) Vs M/s SATYA POWER AND ISPAT [2023-VIL-1393-ITAT-RPR], in respect of completed/unabated assessments, no addition can be made by AO in absence of any incriminating material found during course of search under Section 132 of the Act. It is thus important that these incriminating evidences be compiled by the Search Team.

Another settled principle for invoking Section 263 is that the order of the AO should be erroneous or prejudicial to interest of revenue. In the case of MANISH PACKAGING PVT. LTD Vs THE PCIT -1, SURAT [2023-VIL-1391-ITAT-SRT], PCIT exercised his jurisdiction under Section 263 of the Act solely on issue that AO has allowed deduction claimed under Section 80IA of the Act in respect of income generated from six wind mills. It was despite the fact that the assessee had furnished form 10CCB with respect to all six wind mill units, unit-wise profit and loss account, balance sheets and explanation for each unit. Such direction was thus quashed.

8. Incase income is not derived from the exercise of property rights only, but is derived from carrying on an adventure or concern in the nature of trade, the income will be considered as a business Income

Income under the Income Tax Act is to be assessed under any of the 5 heads of income. Section 22 and 28 concern income from house property and business income respectively. If the income from a source fall within a specific head, the fact that it may indirectly be covered by another head will not make the income taxable under the latter head. Ownership of house property is itself recognized as a source of income under the Act, which is irrespective of whether the same is let or not. The

only exception qua house property being the source of income is where the same is occupied by the assessee for the purpose of any business or profession carried on by him, income from which is chargeable to tax u/s. 28. Incase income is not derived from the exercise of property rights only, but is derived from carrying on an adventure or concern in the nature of trade, the income will be considered as a business Income as explained by the Apex Court in Karanpura Development Co. Ltd. vs. CIT [1962] 44 ITR 362 (SC), which observations stand also extracted in it's recent decision in Rayala Corp. Pvt. Ltd. v. Asst. CIT [2016] 386 ITR 500 (SC). The line is very thin and thus have to be argued on facts and circumstances. In the case of THE ASSISTANT COMMISSIONER OF INCOME-TAX Vs KNOWELL REALTORS INDIA PRIVATE LIMITED [2023-VIL-1390-ITAT-CHN], the arguments of the asseesee was not acceptable and the income was determined as business income.

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