Direct Tax Vista

Your weekly Direct Tax recap

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1. A Ray of Hope for assesses incase of delayed payment of PF & ESIC

We discussed in our DTV Edn:28 how The Hon'ble Apex Court checkmated the business houses which deduct provident fund and ESIC contribution from the salary of employees and then deposit to the authorities. The Court held in the case of CHECKMATE SERVICES P. LTD Vs COMMISSIONER OF INCOME TAX-1 that any amount which the employers deduct and delay in payment to the Government would not be allowable as a deduction to the employers. In this context the seminal issue of retrospective vs prospective nature of the stated amendment by Finance Act 2021 came up for extensive consideration before Hon'ble Delhi high court in case of PCIT vs TV Today Network Ltd (ITA 227/2022) order dated 27.07.2022 where high court took the view that stated amendment are prospective in nature.

We discussed that in matters which were already pending before first/ second appeal and original disallowance was made in intimation u/s 143(1) of 1961 Act, one may still argue on jurisdictional ground of validity of the adjustment made in summary proceedings u/s 143(1) of 1961 Act and are given restricted and limited scope of proceedings u/s 143(1). The same was done in the case of M/s P R PACKAGING SERVICE Vs ASSISTANT COMMISSIONER OF INCOME TAX [2022-VIL-1576-ITAT-MUM] where the Hon'ble Tribunal being conscious of the fact that the issue on merits was decided against the assessee by the the Hon'ble Supreme Court; yet holding that this decision was rendered in the context where assessment was framed under section 143(3) of the Act and not under section 143(1) (a). Hence it directed the AO to delete the addition made in respect of employees' contribution to Provident Fund, in the facts and circumstances of the instant case where assessment was framed under section 143(1)(a).

2. Assessees should not be punished for their bona fide mistakes or errors as ITR form is highly complicated

For Taxpayers and Tax Authorities, by far the most important Article of The Constitution is Article 265 which requires that no tax shall be levied or collected except by the authority of law. It makes it abundantly clear that The Constitution intended to limit any illegal or wrong action taken by anyone while holding government office, such as collecting taxes by acting disproportionately. When Assessing Authorities act disproportionately, then Courts are dragged into nitty gritty to understand the complexities of compliances with which taxpayers deal. ITR forms have now become more complex and some cells are not even interlinked. The court was taken through these ITR Forms and run through the various columns of the return of income. The assessee inadvertently could not reflect the long-term capital gains in the relevant column “5 of Schedule BP” of the ITR. However, the assessee under the column “Part B” of the ITR has mentioned the tax payable at normal rates as NIL. Since the tax was payable by the assessee was on the MAT income and not on regular income and since there was no interlinking between different columns in the ITR software of the Department, the said claim remained to be entered in the relevant column. However, the same was very much deciphered from the balance sheet, copy of computation of total income, details of long-term gains, short-term loss etc. furnished along with the return of income. Notwithstanding, the benefit was denied which resulted in Hon’ble ITAT remarking in the case of SALEM ERODE INVESTMENTS LTD Vs ACIT, CIRCLE-7(2), KOLKATA [2022-VIL-1579-ITAT-KOL] that Income Tax authorities should charge only legitimate and due tax from the assessees and that the assessees should not be punished for their bona fide mistakes or errors. It noted that the ITR form is highly complicated and since the different columns of the ITR was not interlinked, therefore, there was no auto-correction and hence there was mismatch of figures in the relevant/corresponding columns of ITR. The mistake occurred in not filling the relevant column apparently was a bona fide mistake, for which the assessee should not be burdened with the tax, which it was otherwise not liable to pay.

3. Direct & Indirect Collections estimated to beat budget Estimates. Taxpayers to take note of effective use of technology by the MoF

The net direct tax collections so far this financial year are at ₹7L Crore, an increase of 23% as compared to the same period of the corresponding financial year. Hence the Direct Tax Revenue could also see an uptick against the budgeted figures. Combine this with a 17% estimated uptick in GST revenues for the year compared to budget, it would mean that the Finance Minister would have a lot of cushion from collection of taxes to keep the fiscal deficit in control.

The CBDT has termed it as a clear indicator of the revival of economic activity post-pandemic, as also the result of the stable policies focusing on simplification and streamlining of processes and plugging of tax leakage through effective use of technology. Certainly, the taxpayers are witnessing the last limb i.e. 'effective use of technology' and also the sharing of Data and knowledge between CBDT, CBIC and other agencies. Hence, robust compliances seem the only way forward for all taxpayers going forward.

4. Interest on NPAs should be taxed on receipt basis. No point adding interest on NPAs first and then claiming as bad debts

Can a part of the books of account be on cash basis and a part on accrual basis. When a non-scheduled bank draws up its books on accrual basis, then can it recognize the interest on NPAs on cash basis was the question before the Court. For this, lets understand the background of the Section 43B and 43D.

Section 43B was inserted in the Income-tax Act, 1961 with effect from April 1, 1984. The section, as it originally stood, did not contain the two provisos. The first proviso was inserted by the Finance Act of 1987 which came into effect from April 1, 1988. Explanation 2 has been added subsequently by the Finance Act of 1989 but with retrospective effect from April 1, 1984.

Section 43D of the Income Tax Act was substituted by Finance Act 1999 (27 of 1999) w.e.f. 1st April, 2000, whereas, it had been earlier inserted by Finance Act 1991 w.e.f. 1st April, 1991. Initially the said Section was applicable to scheduled bank, but thereafter, it was amended and was also made applicable to co-operative bank w.e.f. 1st April, 2018. A perusal of the objects at the time of addition of co-operative banks in Section 43D reveals that the same was done with an intention to cure the defect.

Now the question is whether the insertion of proviso can have retrospective application when not specifically stated in the statue. This becomes a question of interpretation of statues rather than a question of Income Tax. In construing statutes the cardinal rule is to construe its provisions literally and grammatically giving the words their ordinary and natural meaning. This rule is also known as the plain meaning rule. The “ut res magis valeat quam pereat” (Rule of Reasonable Construction) implies that a statute must be construed reasonably. A statute or any enacting provision therein must be so construed as to make it effective and operative.

The Apex Court in the case of Allied Motors (P.) Ltd. versus Commissioner of Income-Tax, (1997) 224 ITR 677 laid down that the rule of reasonable construction must be applied while construing a statute. Literal construction should be avoided if it defeats the manifest object and purpose of the Act. A proviso which is inserted to remedy unintended consequences and to made the provision workable, a proviso which supplies an obvious omission in the section and is required to be read into the section to give the section a reasonable interpretation, requires to be treated as retrospective in operation so that a reasonable interpretation can be given to the section as a whole. While there are many judgements to the contrary too, The Hon’ble HP high Court had to decide in the specific case while deciding in the case of PR. COMMISSIONER OF INCOME TAX Vs THE KANGRA CENTRAL CO-OP BANK LTD [2022-VIL-261-HP-DT]. Here since most of the NPAs did not finally yield the interest, the Hon’ble Court decided in favour of the assessee that there is No point adding interest on NPAs first and then claiming as bad debts.

This judgement not only answers the issue raised in the instant case but answers broader questions which may be used in other matters too wherein the rule of reasonable construction can be relied upon.

5. Depreciation expenses is allowed as deduction to a Charitable Organisation before amendment of Act, Manual Revised return to be considered

Charitable trusts or institutions are governed by the provisions of sections 11, 12, 12A, 12AA and 13 under Chapter III of the Income-tax Act. These sections constitute a complete code governing the grant, cancellation or withdrawal of registration, providing exemption of income and also conditions subject to which a charitable trust or institution is required to function in order to be eligible for exemption. Section 11(1)(a) provide exemption to the extent income derived from the property held under trust is applied for charitable purposes Subject to fulfilment of conditions laid down in section 11 exemption is available in respect of income irrespective of whether the expenditure incurred is revenue or capital in nature. Hence, exemption is available even when the income is applied for acquiring a capital asset. In view of this, charitable institutions were not eligible for depreciation.

This view has been clarified in Para 7.5 of the Explanatory Notes to the provisions of the Finance (No. 2) Act, 2014 issued vide Circular No. 1/2015 dated 21st January, 2015. Section 11 was amended by the Finance (No. 2) Act, 2014 whereby a new sub-section has been inserted which provides that under section 11, income for the purposes of its application shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as an application of income under section 11 in the same or any other previous year. This issue has been laid to rest by amendment to section 11 by the Finance (No.2) Act, 2014 which is effective from the assessment year 2015-16 and subsequent years. Hence, w.e.f. 1.4.2015 there is a restriction on claim of depreciation. The amendment is only prospective applicable to AY 2015-16 and subsequent years. The same was held in the case of ACIT (E), CIRCLE-2(1), NEW DELHI Vs SOFTWARE TECHNOLOGY PARKS OF INDIA [2022-VIL-1580-ITAT-DEL].

Further, it was held that it is a filmsy ground to deny an exemption for a defect in the original e-return and subsequent filing of a manual return. Not claiming exemption in the original return, though otherwise legally admissible on facts cannot be fatal when the assessee does claim exemption in the revised return which should be duly considered for the purposes of making assessment.

6. Are 'Outstanding Receivables' an International Transaction?

In our DTV Edn: 32 we discussed the decision of M/s INTEGRA SOFTWARE SERVICES P LTD Vs DCIT [2022-VIL-1433-ITAT-CHE]. It was held that Incase of a delay in realization of receivables from AE as well as Non-AEs is beyond the control of an Entity and Incase it did not charge any interest from AE as well as non-AEs, deemed Interest cannot be a TP Adjustment. Further incase TNMM method is applied, it will itself take care of all such costs. Furthermore, incase the assessee itself is a debt free company, then no deemed interest on receivables can be applied. However, incase AEs are granted advances then interest adjustment is required. Hence, the allegation of the assessee accommodating its AEs in the guise of receivables would not sustain.

However, post Finance Act 2012, Explanation was inserted to Section 92B which reads as follows-

> *"(i) the expression "international transaction" shall include—*
> *(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;"*

Hence in the same Tribunal in the case of EXCELLENCE DATA RESEARCH PVT. LTD. Vs ACIT [2022-VIL-1581-ITAT-CHE] held that receivables during the course of business was an international transaction liable for TP adjustment since it was overdue for a period in excess of its normal credit period.

These cases are the right examples before young lawyers to understand to not rely on mere precedents but also to see distinguishing factors in various matters.

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