

# Direct Tax Vista

Your weekly Direct Tax recap

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## 1. Cash received on various days to be not considered as “in relation to one event or occasion”

Section 269ST(c) provides that no person is allowed to receive a sum of Rs. 2,00,000 or more, from a person “in relation to one event or occasion”, in cash or an impermissible mode. Any contravention of this provision attracts a penalty under Section 271DA.

The question was whether receipt of cash by Co-operative Societies from a distributor for the sale of milk on a bank holiday or a day when the bank is closed should be considered a single transaction or aggregated with all such cash receipts from the distributor in the previous year to be treated as a single event or occasion under Section 269ST.

It was clarified by the board **Vide Circular No. 25/2022** in respect of Co-operative Societies, that a dealership/ distributorship contract by itself may not constitute an event or occasion for the purposes of Section 269ST. Thus, all such receipts by societies from dealers should not be aggregated across multiple days for the purposes of Section 269ST

Whether this analogy will be applied incase of various other industries like healthcare, real estate, retail, etc would be required to be seen going forward.

## 2. Demonetization declared legal

The Constitutionally Valid of Demonetization was upheld by The Apex Court in the case *Vivek Narayan Sharma vs. Union of India* (2023) (SC) . Herein, the Constitutional validity of RBI Notification No. 3407(E) dt. 08.11.2016 was challenged.

The Supreme Court has held that the power available to the Central Government u/s 26(2) of the RBI Act CANNOT BE RESTRICTED to mean that it can be exercised only for 'one' or 'some' series of bank notes and not for 'all' series of bank notes. The power can be exercised for all series of bank notes. Merely because on 2 earlier occasions, the demonetization exercise was by plenary legislation, it cannot be held that such a power would not be available to the Central Government u/s 26(2) of the RBI Act.

The Court laid down that there was no question on the noble intention behind demonitization and its objective. Hence The Court did not wish to hold demonetization as illegal purely on legalistic analysis.

Out of Total 5 Judges Bench, 4 Judges decided the matter in favour of the Central Govt while Justice B. V. Nagarathna wrote his separate dissenting Order.

### **3. Non-routine product promotion expenses cannot be considered as Service applying 'Bright Line Test'**

Transfer Pricing Litigation concerning Advertising marketing and sales promotion (AMP Expenses) and creation of Marketing Intangibles for the Foreign Associated Enterprise, has come to the fore in recent years. Accordingly, the TPOs in India, apply the 'Bright Line Test' as laid down in the decision of US Tax Court in DHL Inc.'s case, have held that the expenditure on advertisement and brand promotion expenses which exceed the average of AMP expenses incurred by the comparable companies in India, is required to be reimbursed/ compensated by the overseas associated enterprise. The principle followed by the Tax Department is that the excess AMP expenditure incurred by the Indian AE contributes towards the development and enhancement of the brand owned by the parent of the multinational group (the foreign AE). This perceived enhancement in the value of the brand is commonly referred to as 'marketing intangibles'. The Tax Court in the case of DHL coined the concept of a 'Bright Line Test' ('BLT') by differentiating the routine expenses and non-routine expenses. In brief, it provided that for the determination of the economic ownership of an intangible, there must be a

determination of the non-routine (i.e. brand building) expenses as opposed to the routine expenses normally incurred by a distributor in promoting its product.

The Tax Department ought to appreciate the difference between “product promotion” and “brand promotion”. Product promotion primarily targets an increase in the demand for a particular product whereas Brand Promotion results in creation of Marketing Intangibles. Further, when TNMM Method is applied, then the entire bundle of the transactions including the revenue earned and the expenses incurred to earn such revenue are treated together. The product promotion expenditure incurred cannot be singled out again and treated as a separate transaction with the AE to find out the ALP.

Where the operating profit to the total operating cost was adopted as Profit Level Indicator. It means that the AMP (advertising, marketing and Promotion) expenditure was not considered as a part of the operating cost. No TP adjustment can be made by deducing from the difference between AMP expenditure incurred by assessee company and AMP expenditure of comparable entity, if there is no explicit arrangement between the assessee - company and its foreign AE for incurring such expenditure. The fact that the benefit of such AMP expenditure would also ensure to its foreign AE is not sufficient to infer existence of international transaction. The onus lies on the revenue to prove the existence of international transaction involving AMP expenditure between the assessee company and its foreign AE. Accordingly, in the case of **ALCON LABORATORIES (INDIA) PRIVATE LTD Vs THE DEPUTY COMMISSIONER OF INCOME TAX [2022-VIL-1638-ITAT-BLR]**, It was held that Expenses incurred by assessee is not an international transaction and incidental benefit accruing to AE cannot be considered as provision of service.

#### **4. DTAA would prevail over Section 206AA ...even before the amendment**

Finance Act 2016 has liberalized the provisions of S.206AA by inserting S.206AA(7)(ii) which provides that s.206AA shall not apply to payments to non-residents subject to conditions as may be prescribed. CBDT has thereafter notified Rule 37BC which provides that if the non-resident payee furnishes certain information and documents like TRC or Unique Identification number in his home

country, S.206AA shall not apply to specified payments viz. interest, royalty, FTS and capital gains. This amendment was pursuant to recommendations in the first report of the Income Tax Simplification Committee.

Now there are disputes on whether the amendments are more of a clarificatory nature and whether a retrospective application be given to the amendment for earlier disputes or not. Notwithstanding, the issue, even for earlier disputes which keep on arising, reliance can be placed on various judgement of the Courts wherein Section 206AA was required to be read down. DTAA overrides the Act, even if it is inconsistent with the Act. DTAA's are entered into between two nations in good faith and are supposed to be interpreted in good faith. Otherwise it would amount to the breach of Article 253 of the constitution.

The Hon'ble Supreme Court decision in the case of Azadi Bachao Andolan (2003) 263 ITR 706 (SC), dealt with the issue whereby it was held that DTAA, even if inconsistent, will prevail over the Act. The Hon'ble Delhi High Court in the case of Danisco India Private Limited Vs. Union Of India & Ors. (Delhi High Court) in W.P.(C) 5908/2015 Judgement/Order dated 05/02/2018 held that where reciprocating states mutually agree upon acceptable principles for tax treatment, the provision in Section 206AA has to be read down to mean that where the deductee i.e., the overseas resident business concern conducts its operation from a territory, whose Government has entered into a Double Taxation Avoidance Agreement with India, the rate of taxation would be as dictated by the provisions of the treaty.

The same proposition was upheld recently in the case of **THE COMMISSIONER OF INCOME-TAX INTERNATIONAL TAXATION, BENGALURU Vs M/s WIPRO LTD [2022-VIL-270-KAR-IT]**

## **5. Percentage Completion Method for Undisclosed Cash Receipts!**

Is an Excel sheet found during search, corroborative evidence? Is a figure mentioned in such sheet reliable? Whether undated and unsigned details can be considered as 'evidence' on the basis of which tax can be levied? Is an excel sheet just a dump document? The same has also to be answered keeping in view Section 132(4A) of

The Income Tax Act which provides that where any books of account, other documents, money, bullion, jewellery or other valuable article or thing are or is found in the possession or control of any person in the course of a search, it may be presumed that such books of account, other documents, money, bullion, jewellery or other valuable article or thing belong or belongs to such person ; that the contents of such books of account and other documents are true ; and that the signature and every other part of such books of account and other documents which purport to be in the handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting, and in the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.

To answer this one must firstly look into Section 156 of The Indian Evidence Act which states as follows -

*"When a witness whom it is intended to corroborate gives evidence of any relevant fact, he may be questioned as to any other circumstances which he observed at or near to the time or place at which such relevant fact occurred, if the Court is of opinion that such circumstances, if proved, would corroborate the testimony of the witness as to the relevant fact which he testifies. Illustration A, an accomplice, gives an account of a robbery in which he took part. He describes various incidents unconnected with the robbery which occurred on his way to and from the place where it was committed. Independent evidence of these facts may be given in order to corroborate his evidence as to the robbery itself."*

Hence, Corroborating evidence is evidence that strengthens or confirms already existing evidence. Omissions and contradictions come in the way of inspiring confidence about credibility of the witness and the evidence. The proof of Contradiction is vital to destroy the credibility of the case. Therefore, it is important for the AO to look into the fact that the presumption under section 132(4A) of the Act is rebuttable and where there is denial of such presumption, onus shifts to the

Ld. AO to make further investigation. An attempt has to be made then to examine the said parties to establish the veracity of the entries made in the xls sheet. Addresses of such parties have also to be found out.

Hence where Pursuant to search and seizure conducted, AO reopened case of assessee under Section 147 of the Act and made addition on account of unexplained cash receipt treating it as being against booking of space and applying Percentage Completion Method of revenue recognition, the matter was remanded back in the case of **DCIT, CENTRAL CIRCLE18, NEW DELHI Vs M/s CELEBRATION CITY PROJECTS LTD [2022-VIL-1639-ITAT-DEL]**. It was held that the Record of assessee needs to be examined as to either in its case Percentage Completion Method has been applied or assessment has been made on basis of Project Completion Method.

## **6. Forward Loss for Hedging allowable as expenditure**

Can the loss on Forward Cover Purchase Contracts for foreign exchange be allowed as a deduction from the income chargeable to tax notwithstanding that the Forward Contracts have not closed?

Herein, lets understand the Accounting Treatment first. The valuation-loss is reflected on the debit side of the P&L account whereas the corresponding valuation Gains resulting on the valuation of the debtors is reflected on the credit side included as part of sales / exchange Gains and in respect of imports as reduction in the import price on the debit of the Profit & Loss account. The entire transaction of either realization of debtors in foreign exchange / payment for imports in foreign exchange which are designated in foreign currency and the entering into Forward cover contract are integral part of the same transaction i.e. two sides of the same coin. By considering both sides of the P&L the correct net profit is worked out. Therefore, in order to ascertain the correct taxable profits of the appellant the loss has to be allowed as a business loss because it is due to the business exigency the forward contracts are entered into to protect against any loss that might result due to foreign exchange currency fluctuation foreign currency fluctuation. The said treatment is also in accordance with AS-11.

The matter has been dealt with in CBDT Instruction No 03/2010 where it was held that 'Marked to Market' where financial instruments are valued at market rate to report their actual value on the date of reporting represent notional losses and were required to be added back for the purposes of computing taxable income. However, the CBDT also instructed the AOs to examine whether such transactions were speculative transactions where losses on account of forex-derivative transactions arise on actual transaction.

The said circular, hence is not applicable where the transaction could not be considered as a speculative transaction as they fall within the exceptions of proviso (a) to Section 43(5) of the Act. In CIT v. Woodward Governor India Pvt. Ltd. (supra), the Supreme Court had referred to AS-11. In terms of AS11, the exchange difference arising on foreign currency transactions are necessary to be recognized as income or expense in the period in which they arise, except in cases of exchange differences arising on repayment of liabilities for acquiring fixed assets. In case the Assessee is reinstating its debtors and creditors in connection with execution of contracts entered into with foreign entities on the basis of the value of the foreign exchange, it is allowed as an expense u/s 37(1) of The Income Tax Act. The same was held in the case of PRINCIPAL COMMISSIONER OF INCOME TAX, DELHI-2 Vs SIMON INDIA LTD [2022-VIL-269-DEL-DT]

## **7. Payment pursuant to arbitration award is business expenditure**

Explanation 1 to section 37 (1) of the Act reads that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or relevance shall be made in respect of such expenditure. The question is whether the amount paid to arbitrator or pursuant to the arbitration award on the allegation of the counterparty that there was breach of obligation pursuant to a contract, can be said to be for the purpose of any offence or that the same is prohibited by any law? Can Breach of contractual obligation cannot be said to be an offence under any law?

Payment pursuant to an award for arbitration is towards settlement of a compensation to save oneself from future litigation costs and to save brand image in the market. The agreements also have an 'arbitration clause' which reads that in the event of dishonesty, poor performance and/or violation of any provision of the agreement by either party, both the parties shall do their best effort to settle the matter in dispute in a prompt and amicable manner. There is no mention of any penal clause/action in the event of violation of any provisions of the agreement.

The Hon'ble Apex Court in the case of Navsari Cotton evolved the tests on principles to claim deduction of an expenditure as business expenditure, and it includes, the expenditure incurred with a view to bring profits or monetary advantages today or tomorrow, to render the assessee immune from impending or reasonably apprehended litigation, in order to save losses in foreseeable future, for affecting economy in working which may pay dividends today or tomorrow, for increasing efficiency and working and for removing inefficiency in the working.

Hence, the payment for breach of contractual obligation pursuant to an arbitration award in the pending litigation, cannot be said to have been incurred for any purpose which is an offence or which is prohibited by law. The same was held in the case of DY. COMMISSIONER OF INCOME TAX Vs M/s NIPRO MEDICAL INDIA PRIVATE LIMITED [2022-VIL-1633-ITAT-HYD]

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