Direct Tax Vista

Your weekly Direct Tax recap

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1. Global Minimum Tax to result in gains of 9% of Global Tax Revenues

To usher in a Tax mammoth tax reform, among all other considerations, the most important consideration is that it should lead to a gain which is worth the pains to implement it. Infact the machinery involved in the process have to constantly keep reviewing the expected gains so as to keep the project in fast track. Global Minimum Tax (GMT) which was already on fast track has received further wings as an updated Analysis on OECD's earlier assessments, including its detailed Economic Impact Assessment issued in October 2020, shows that projected revenue gains under Pillar One have increased, and continue to rise over time, due to two reasons –

1. Revisions to the design of the tax reform
2. Increased profitability of in-scope MNEs.

It also shows increased projected revenue gains from Pillar Two, which reflects some increases in global low-taxed profit, including as a result of improved data coverage.

It is now expected that the proposed global minimum tax may result in annual global revenue gains of around USD 220 billion, or 9% of global corporate income tax revenues. This is a significant increase over the OECD's previous estimate of USD 150 billion in additional annual tax revenues attributed to the minimum tax component of Pillar Two. Pillar One, designed to ensure a fairer distribution of taxing rights among jurisdictions over the largest and most profitable multinational enterprises (MNEs) is now expected to allocate taxing rights on about USD 200 billion in profits to market jurisdictions annually. This is expected to lead to annual global tax revenue gains of between USD 13-36 billion, based on 2021 data. The analysis finds that low and middle-income countries are expected to gain the most as a share of existing corporate income tax revenues

One must also keep an eye on the schedule for completion of the work on Amount A which requires that the detailed provisions of the MLC and its Explanatory Statement, be completed so that a signing ceremony of the MLC can be held in the first half of 2023 with the objective of enabling it to enter into force in 2024 once a critical mass of jurisdictions as defined by the MLC have ratified it.

Corporate Tax Managers and professionals thus have to keep an eye on the developments in this regard and take first mover advantage.

2. Applications of the theory that 'Real Income' is only liable to be taxed.

Even under the mercantile system, in order to put an income to tax, the same must become actually due no matter when it is received and that income cannot be said to have accrued to an assessee-company if it is based on a mere claim not backed by any legal or contractual right to receive the amount at a subsequent date. Tax can be imposed only if there is real income and income tax cannot be imposed on hypothetical income. The notional interest awarded by the a Court of Arbitration, which has attained finality is a hypothetical income which cannot be subjected to tax. Merely because the said amount has been awarded by way of an order, does not mean that the assessee has received such income. Under mercantile system of accounting, there cannot be a situation of hypothetical income being taxed was held in the case of THE SPECIAL RANGE-6 NEW DELHI Vs NATIONAL FERTILIZERS LTD [2023-VIL-111-ITAT-DEL].

'Real Income Theory' was also applied where a claim was made by an electricity company at the increased rates. It was held by The Hon'ble Apex Court in the case of Godhra Electricity Co. Ltd. v. CIT, (1997) 225 ITR 746 (SC), that the impugned amounts as brought to tax by the income tax officer did not represent the income which had really accrued to the assessee-company during the relevant previous years.

Again, Hon'ble Supreme Court in various rulings including in the case of E. D. Sassoon and Company Ltd [1954] (26 ITR 27) has held that for an income to be taxed, there should be right to receive the income and liability on the payer to make payment of such income.

Even in Transfer Pricing Cases, The Apex Court's judgments and the "real income theory" principles squarely apply. For example it applies incases of determining ALP for notional interest on outstanding receivables from Associated Enterprises. In the case of Evonik Degussa India Pvt. Ltd., in ITA No. 7653/Mum/2011 Honourable Mumbai Tribunal observed that T.P. adjustment cannot be made on hypothetical and notional basis until and unless there is some material on record that there has been under charging of real income.

In cases where the whole transaction is not verifiable due to various reasons, the only taxable is the taxable income component (gross profit) and not the entire transaction. The Bombay High Court in the case of CIT vs. Hariram Bhambani opined that under Income Tax Act only real income can be taxed by the Revenue.

This theory is important and can be used in various other matters.

3. Allowability of demurrage and wharfage expenses

Demurrage is paid to the Railways for not lifting the goods consigned to it in time to compensate it for keeping the goods of the assessed in its custody beyond a particular time. Similarly, the port authorities charge demurrage for delay in clearing the goods from the godowns of the port authorities which includes charges for storage and safe custody of the good and also for delayed clearance. The payment essentially is by way of liquidated damages for use of the port facilities beyond the period allowed under the port Rules.

It was held that the demurrage paid was not a fine for infraction of any law but was by way of compensation for use of port facilities beyond the period allowed under the Port Trust Rules, and that the expenditure on this account was laid out wholly and exclusively for the assessee's business.

As regards wharfage charges, they are charges paid to facilitate the loading / unloading of goods at waterfront and for providing facilities. Further as regards TDS on wharfage charges, it was held by The ITAT Pune in the case of M/s. Angre Port (P) Ltd. Vs ITO (ITAT Pune) that they are charged from the assessee that there is no use of land but even if it was held that there is any use of land, then the same was incidental but such payments could not be treated as 'rent' and the assessee be liable to deduct tax at source under section 194-I of the Income Act.

The above were also decided in the case of THE SPECIAL RANGE-6 NEW DELHI Vs NATIONAL FERTILIZERS LTD [2023-VIL-111-ITAT-DEL].

4. Interest on delayed Income Tax / TDS / GST / any statutory payment: when allowed as a deduction

In claiming the deduction u/s. 37(1) for interest u/s. 201(1A), an issue arises as to whether such interest can be considered to be incurred wholly and exclusively for the purpose of business or profession. The issue is relevant for a large number of assessees. The Supreme Court decision in the case of Bharat Commerce & Industries Ltd. vs. CIT (198) 230 ITR 733 (SC), held that interest on late payment of Income Tax was not allowable. It held that the interest levied u/s. 139 and section 215 of the Income-tax Act was not deductible as a business expenditure u/s. 37(1) of the Act. The court held that the income tax was a tax on profit of the business and was therefore not allowable as a deduction. Similarly, interest also was not deductible as the same was inextricably connected with the assessee's tax liability; if the income tax was not a permissible deduction u/s. 37, any interest payable for default in payment of such income tax could not be allowed as a deduction. In arriving at the conclusion, the court followed its own decision in the cases of East India Pharmaceutical Works Ltd, 224 ITR 627 and Smt. Padmavati Jaikrishna, 166 ITR 176, where decisions dealt with the issue of deductibility of interest paid on moneys borrowed for payment of income tax. The Court held that -

> *'...When interest is paid for committing a default in respect of a statutory liability to pay advance tax, the amount paid and the expenditure incurred in*

that connection is in no way connected with preserving or promoting the business of the assessee. This is not expenditure which is incurred and which has to be taken into account before the profits of the business are calculated. The liability in the case of payment of income- tax and interest for delayed payment of income-tax of advance tax arises on the computation of the profits and gains of business. The tax which is payable is on the assessee's income after the income is determined. This cannot, therefore, be considered as an expenditure for the purpose of earning any income or profits...'

In another judgement, The Hon'ble Supreme Court in the case of Lachmandas Mathuradas vs. CIT (2002) 254 ITR 799 (SC) held that interest on arrears or on outstanding balance of sales tax is compensatory in nature and would be allowable as deduction in computing profits of a business. Referring to the same decision, ITAT in the case of Narayani Ispat (P) Ltd in ITA No.2127/Kol/2014 for AY 2010-11 vide order dated 20.08.2017 has held that interest expenses on account of delayed payment of service tax as well as TDS is an allowable expenditure.

On the same lines, it was held in the case of UNIVERSAL ENERGIES LTD Vs DCIT, CIRCLE 18 (1), NEW DELHI [2023-VIL-110-ITAT-DEL] that Interest on delayed payment of TDS is allowable as a deduction.

Hence, it can be construed that interest on delayed payment of a statutory liability would take its colour from the principal amount and thus, it could be considered to be incurred wholly and exclusively for the purpose of business and consequently, such interest cannot be claimed as a deduction, incase the principal amount paid can be so claimed as a deduction. TDS, by itself, does not represent income tax of the assessee, but is a deduction from the payment made to a party in respect of expenses claimed by the assessee. So long as the expenses from which tax is deducted, relate to the business of the assessee, the TDS thereon would also be considered to be relating to the business of the assessee and therefore, interest on delayed payment of such TDS would be considered to be incurred wholly and exclusively for the purpose of business. Similarly, GST/Service Tax are allowable as a deduction to the assessee and hence the delayed payment of Interest also should be allowable as a deduction.

5. Cash payment to directors in violation of Section 40A(3) allowed

The intention behind introduction of provisions of section 40A(3) of the Act was two-fold –

1. Firstly, putting a check on trading transactions with a mind to evade the liability to tax on income earned out of such transaction and
2. Secondly, to inculcate the banking habits amongst the business community.

The provision was directly related to curb the evasion of tax and inculcating the banking habits. The consequence, which were to befall on account of non-observation of section 40A(3) must have nexus to the failure of such object. Provisions of Section 40A(3) are thus not absolute. The genuineness of the transaction, it being free from vice of any device of evasion of tax is a relevant consideration to protect the assessee from the vigours of this section.

The payment by crossed cheque or crossed bank draft is insisted to enable assessing authority to ascertain whether the payment was genuine or whether it was out of the income from disclosed sources. Thus, the genuine and bona fide transactions, where the identity of the payee is established, are taken out of the sweep of the section. Incase, the payee insists for payments in cash, the identity of the payee is not in doubt and AO does not disputed the genuineness of the transaction, then the same may not be subject to the vigours of Section 40A(3).

The Department may require the assessee to prove the commercial expediency for making payments in cash. This test of commercial expediency should be judged from the view point of the businessman and not from the view point of the revenue. The expression "commercial expediency" has been explained by their Lordships of the Hon'ble Apex court in the case of S.A. Builders Ltd. v. CIT (Appeals) in which it was held that the expression "commercial expediency" is an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business.

The Hon'ble apex court in the case of Attar Singh Gurmukh Singh v. ITO while considering the constitutional validity of Section 40A(3) has also explained the reasons behind introduction of this provision. Various High Courts in the following cases have also taken the view that where the payment is genuine, there cannot be denial of deduction of genuine and bona fide business expenditure merely because the assessee could not make the payment as provided in Section 40A(3):

(a) CIT v. Rhydburg Pharmaceuticals Ltd. ;
(b) Girdharilal Goenka v. CIT ;
(c) CIT v. Chaudhary and Co. ;
(d) Shri Mahabir Industries v. CIT ;
(e) CIT v. Chrome Leather Co. P. Ltd. ;
(f) CIT v. Mrinalini V. Sarabhai ; and
(g) Walford Transport (Eastern India) Ltd. v. CIT .

As per article 265 of the Constitution of India, no tax shall be levied or collected except by authority of law. Such dictum of the Constitution would necessarily exclude any interpretation of the statute that would result in denial of deduction of genuine business expenditure and consequent undue enrichment of the exchequer. In the case of K.P. Varghese v. ITO, The Hon’ble Apex Court held that the onus of establishing that the conditions of taxability are fulfilled is always on the Revenue and the statutory provisions must be construed so that absurdity and mischief may be avoided.

Hence incase cash payments are made to directors, it may be considered as a genuine and bona fide transaction as the director to whom the payment was made is clearly identifiable. The same was held in the case of SHREENATH COMMERCIAL & FINANCIAL PVT LTD Vs ITO WARD-4(1)(3), AHMEDABAD [2023-VIL-109-ITAT-AHM].

The same analogy can be applied to payment made to uneducated and unorganized labourers, contractors, etc.

6. Is CSR Expenditure allowable u/s 80G?

In the recent past a litigated issue is "Donations given towards CSR Expenses and its allowability as deduction U/s 80G". The question whether contributions made under CSR are eligible for deduction u/s 80G of Income tax 1961 or not, is compounded further by The Ministry of Corporate Affairs (MCA) General Circular No. 14 /2021, Dated: 25th August 2021. In this circular MCA has answered various Frequently Asked Questions (FAQ).

> **FAQ 3.11**: What tax benefits can be availed under CSR?
> **MCA's Answer**: No specific tax exemptions have been extended to CSR expenditure. The Finance Act, 2014 also clarifies that expenditure on CSR does not form part of business expenditure.

To set in the context, earlier taxpayers were claiming CSR expenditure as business expenditure. However, the Finance (No 2) Act, 2014 introduced Explanation 2 to Section 37(1) (Applicable form AY 15-16) to disallow any expenditure incurred by the taxpayer on the activities relating to CSR referred to in Section 135 of the Companies Act. After the amendment, some tax authorities not only disallowed the expenditure under Section 37(1) but have also disputed the claim of deduction under Section 80G for eligible donations, qualifying for CSR. Let us understand the contention of the AOs in this regard in further details-

- CSR expenditure is not 'voluntary', but 'mandatory' in Nature, whereas 80G deduction should be allowed in a case of 'voluntary' payment.
- The intention of the legislature was never to allow deduction for CSR expenditure, else it would result in subsidising the CSR expenditure by one-third amount.

The following is the taxpayer's defence in this respect -

- As per the plain reading of Explanation to 2 to section 37(1) of the ITA, any expenditure incurred towards CSR activities as referred to in section 135 of the Companies Act, 2013 is not allowed as 'business expenditure'. The embargo created by this provision was to deny deduction for CSR expenses incurred by companies, as and by way of regular business expenditure while computing income under the head "Income from Business and Profession".
- It could not be extended or imported to CSR contribution which was otherwise eligible for deduction under any other provision or Chapter
- As per section 80G, deduction has to be made in accordance with and subject to the provisions of the said section. There is no prohibition or restriction placed by the Income Tax Act on such a donation even if shown as CSR expenditure.
- The restriction in respect of expenditure made by the taxpayer to any other fund or institution as referred to in section 80G(2)(a)(iv) of the ITA had not been placed by the legislature. And if the Parliament desired, it could have made such kind of / any restriction like in the case of donation to Swach Bharat Kosh and Clean Ganga Fund.
- As per the interpretation maxim "Expressio Unius Esl Exclusio Alterius", a Latin phrase, "express mention of one thing excludes all others". The phrase indicates that items not on the list are assumed not to be covered by the statute.

The arguments of the assessee have been accepted in a recent case of MARSH MCLENNAN GLOBAL SERVICES INDIA PRIVATE LIMITED Vs ASSESSMENT UNIT, INCOME TAX DEPARTMENT [2023-VIL-81-ITAT-MUM] taking a cue from some of multifarious judgements in this aspect like the following –

Goldman Sachs Services (P.) Ltd. V. Jt. CIT [2020] 117 Taxmann.com 535 (Bang. – Trib.)
Allegis Services (India) (P.) Ltd. V. Asstt. CIT [IT Appeal No. 1693 (Bang.) of 2019, Dated 29-4-2020]

FNF India (P.) Ltd. V. Asstt. CIT [IT Appeal No. 1565 (Bang.) Of 2019, Dated 5-1-2021]

Malabar Industries Ltd. V. CIT [2000] 109 Taxman 66/243 ITR 83 (SC)]

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