Direct Tax Vista

Your weekly Direct Tax recap

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1. PMLA Act and Maintenance of records become more stringent

The Ministry of Finance has notified an amendment in Prevention of Money-Laundering Act, 2002. The amendment aims to expand the scope of the Act to cover a wide range of cryptocurrency or virtual digital assets (VDA) transactions under the purview of PMLA, 2002. Under the new amendment, activities by a person carrying on designated business or profession under section 2(1)(sa) of the PMLA, 2002, shall also include the activities involving exchange between VDAs and fiat currencies, or exchange between one or more forms of VDA and transfer of VDA; Also to store VDA which enables control over VDA as well as participation in and provision of financial services related to a VDA would be covered. An entity dealing in VDAs will now be considered a 'reporting entity' under the PMLA.

Further maintenance of records have been made more elaborate wherein on the one hand non-profit organisations have been linked to those NPOs which are constituted u/s 2(15) of the IT Act, on the other hand Even a 10% and not 15% of controlling interest in a trust would make a person have beneficial interest in the trust. In addition to other details, now if a client is a trust, then documents relating to all trustees have to be submitted by the reporting entity. If the client is a non-profit organization, reporting entities must also register the client's information on the NITI Aayog's DARPAN portal.

In line with existing provisions of The Income-Tax Act, 1961 and The Companies Act, the amended rules have now lowered the threshold for identifying beneficial owners by reporting entities, where the client is acting on behalf of its beneficial owner. Even a 10% and not 25% of controlling interest in a Company would make

a person have beneficial interest in the company; In addition to other details, now a reporting entity has to file details of a client company disclosing the names of the relevant persons holding senior management position; incase client is a partnership firm then documents relating to beneficial owner, managers, officers or employees have to be filed; The amendments require “reporting entities”- banks, other financial institutions, and businesses operating in the real estate and jewellery industries – to gather data on each person.

The necessary due diligence documentation has now expanded beyond just getting the fundamental KYCs of clients, such as registration certificates, PAN copies, and documents of officers with the authority to act on their behalf. Depending on the legal structure of the firm, it now also involves the submission of information, such as the names of those in top management positions, partners, beneficiaries, trustees, settlors, and writers. Moreover, clients must now provide information about their registered office and primary place of business to financial institutions, banks, or intermediaries.

One important development is that Politically exposed persons have been defined to mean as individuals who have been entrusted with prominent public functions by a foreign country, including the heads of States or Governments, senior politicians, senior government or judicial or military officers, senior executives of state-owned corporations and important political party officials. There would certainly be compliance norms for these persons too.
All these developments are expected to have a major impact on the implementation of PMLA Act going forward.

2. Draft Order is a mandatory Procedure u/s 144C for variation in original order

There has been a rise in the number of cases in the recent past wherein AOs have passed the final order without first issuing a draft order and more so in the new environment of faceless assessments. It is also a violation of Explanatory Circular for Finance (No.2) Act, 2009 i.e. Circular No. 5 of 2010 dated 03.06.2010 which states that Assessing Officer is required to forward a draft assessment order to the

eligible assessee, if he proposes to make, on or after the 1st day of October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee. In other words section 144C is applicable to any order which proposes to make variation in income or loss returned by an eligible assessee, on or after 1st October, 2009 irrespective of the assessment year to which it pertains. Amendments to other sections of the Income-tax Act referred to in para 45.3 of the circular 5/2010 dated 3rd June, 2010 shall also apply from 1st October, 2009.

Further, irrespective of any waiver given by the assessee, the AO is mandatorily required first thing first to forward a draft of proposed order of assessment to eligible assessee if he proposes to make any variation which is prejudicial to interest of assessee was held in LINC PEN & PLASTICS LTD. Vs DCIT, CIRCLE-11(1), KOLKATA [2023-VIL-310-ITAT-KOL]. Only after draft of proposed order is served can the AO pass a final assessment order. In absence of following this process, the variation was quashed by the Court. A similar matter met the same fate in ZYDUS HEALTHCARE LIMITED Vs ASSISTANT COMMISSIONER OF INCOME TAX [2023-VIL-308-ITAT-KOL].

3. Interest u/s 36(1)(iii) allowed as deduction even for purchase of Capital Asset

Section 36(1)(iii) of The IT Act provides as under-

(iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession :

Provided *that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction….***

This section was amended twice viz: by Finance Act 2003 and Finance Act 2015. Before the amendments, a deduction was allowed in respect of interest on capital

borrowed for the purposes of business or profession. The said provision has been prone to litigation on the issue of allowability of interest on borrowings for acquisition of assets for extension of business for the period during which the asset was not yet put to use. It was therefore, provided that with effect from assessment year 2004-05, no deduction will be allowed in respect of any amount of interest paid, in respect of capital borrowed for acquisition of asset for the period beginning from the date on which the capital was borrowed for the acquisition of the asset till the date on which such asset was first put to use.

By the Finance Act 2015, the words "for extension of existing business or profession" in proviso was omitted. The provisions of proviso to clause (*iii*) of sub-section (1) of section 36 of the Income-tax Act had been amended so as to provide that the borrowing cost incurred for acquisition of an asset shall be capitalised up to the date the asset is put to use without making any distinction as to whether an asset is acquired for extension of existing business or not.

The question is whether interest on Borrowing for Purchase of land is allowed Section 36(1)(iii) of the Act. The same was taken up in the case of ACIT, CIRCLE-3(1) (2) Vs M/s. FRONTLINE REALTY PVT. LTD. [2023-VIL-311-ITAT-MUM]. While adjudicating claim for deduction under Section 36(1)(iii), the nature of expense was held irrelevant, as Section itself says that interest paid by assessee on capital borrowed was an item of deduction. It was held that where an assessee claims deduction of interest paid on capital borrowed, assessee had to show that capital which was borrowed was used for business purpose in relevant year and it did not matter either capital was borrowed in order to acquire a revenue asset or a capital asset. Only disallowance can be as per provisio to Section 36(1)(iii) i.e. for the period beginning from the date on which the capital was borrowed for the acquisition of the asset till the date on which such asset was first put to use.

4. No case u/s 68 for shares held for very long periods

In cases of penny stocks the holding period of the shares is generally from 1 to 2 years and that too depending upon the price movement of the stock. An investor will not wait for more 15-20 years to get his black money converted through the

price rigging. The same was held in the case of ACIT Vs SMT. ANJU JAIN [2023-VIL-305-ITAT-DEL]

The genuineness of transactions cannot be doubted merely because of a report of investigation wing which hinges on modus operandi and recording of statement of various unidentified persons who neither have a link with the assessee nor have made any allegation qua the assessee or the transactions carried out by Assessee.

5. Commission income for providing 'bogus entries' fixed at 0.5%

During the course of a proceeding the AO noticed that the Assessee was engaged in providing bogus accommodation entries in lieu of commission of 1-1.5% by providing entry through various shell companies. However there are unavoidable statutory expenses also like STT, Exchange Trading/Broker Credit Stamp duty, Exchange Turnover Tax, GST and Sebi Cess. Then there are software expenses, Accounting Expenses, office expenses, Salary expenses, Office Rent and other expenses which have to be considered to derive 'real income'. The AO treated commission income of 0.6% on total credit over and above the returned income of the assessee. The AO assessed the assessee's income u/s 147 in the case of VIKAS GUPTA Vs ACIT, CENTRAL CIRCLE-32, DELHI [2023-VIL-303-ITAT-DEL]. The Hon'ble Delhi High Court in the case of DCIT Vs. M/s Bhawani portfolio Pvt. Ltd. [ITA 158/2020 dated 12.7.2021] has also confirmed 0.5% of the credits as a reasonable real income.

This case reaffirms the fact that in income tax even 'illegal income' has to be offered for tax. Just for the clarification of those who are still questioning as to why crypto-tax was introduced!

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